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# Fourth report on diplomatic protection

**by Mr. John Dugard, Special Rapporteur**

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# A. Diplomatic protection of corporations and shareholders

## 1. Introduction*

1. The three previous reports submitted by the present Special Rapporteur,[1] and considered by the International Law Commission, have dealt with the diplomatic protection of natural persons and the exhaustion of local remedies rule. Although the subject of diplomatic protection of legal persons has been raised from time to time in the course of the debates in the Commission, no direct attention has been given to the subject. In the fifty-fourth session of the Commission in 2002, an informal consultation was, however, held on the diplomatic protection of corporations.[2]

2. The present report is devoted entirely to the subject of the diplomatic protection of corporations and of shareholders in such corporations.

## 2. The *Barcelona Traction* case

3. The diplomatic protection of corporations and shareholders has been addressed in many judicial decisions. However, one decision dominates all discussion of this topic — the *Case Concerning the Barcelona Traction, Light and Power Company, Limited*[3] (hereinafter *Barcelona Traction*). No serious attempt can be made to formulate a rule or rules on this subject without a full consideration of this decision of the International Court of Justice (ICJ), rendered in 1970, its implications and the criticisms to which it has been subjected. The present report, therefore, begins with a consideration of *Barcelona Traction*.

*Judgment of the Court*

4. The Barcelona Traction, Light and Power Company Limited was a company incorporated in 1911 in Toronto, Canada, where it had its head office, which carried on business in Spain. Some years after the First World War, Barcelona Traction's share capital came to be held largely by Belgian nationals — natural or legal persons. At the critical time it is estimated that 88 per cent of the shares were held by Belgian nationals. As a result of a number of actions taken by the Spanish authorities the company was rendered economically defunct. Belgium, the State of nationality of the majority shareholding, and not Canada, the State of nationality of the corporation, then instituted proceedings against Spain for reparation. Spain raised four preliminary objections to the Belgian claim, two of which were dismissed in 1964,[4] while the other two were joined to the merits. One of the objections joined to the merits concerned the right of Belgium to exercise diplomatic protection on behalf of its shareholders in a company incorporated in Canada. It is the decision of the International Court of Justice upholding this preliminary objection that forms the subject of the present report.

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[1] A/CN.4/506 and Corr.1 and Add.1 (2000); A/CN.4/514 and Corr.1 and 2 (2001); A/CN.4/523 and Add.1 (2002).

[2] *Official Records of the General Assembly, Fifty-seventh session, Supplement No. 10* (A/57/10), para. 113.

[3] *1970 I.C.J. Reports*, p. 3.

[4] *1964 I.C.J. Reports*, p. 5.

5. The Court emphasized at the outset that it was concerned only with the question of the diplomatic protection of shareholders in "a limited liability company whose capital is represented by shares".[5] Such companies are characterized by a clear distinction between company and shareholders.[6] Whenever a shareholder's interests are harmed by an injury to the company, it is to the company that the shareholder must look to take action, for "although two separate entities may have suffered from the same wrong, it is only one entity whose rights have been infringed".[7] Only where the act complained of is aimed at the direct rights of the shareholders does a shareholder have an independent right of action.[8] Such principles governing the distinction between company and shareholders are derived from municipal law and not international law.[9]

6. Guided by these general principles of law found in municipal legal systems, the Court expounded the rule that the right of diplomatic protection in respect of an injury to a corporation belongs to the State under the laws of which the corporation is incorporated and in whose territory it has its registered office,[10] and not to the national State(s) of the shareholders of the corporation. In so finding, the Court declined to follow both judicial decisions dealing with the characterization of enemy companies in time of war[11] and State practice in respect of lump sum agreements,[12] which suggest that there might be a rule in favour of lifting the corporate veil in order to allow the State(s) of nationality of shareholders to exercise diplomatic protection on their behalf. Although the Court acknowledged that bilateral or multilateral investment treaties might confer direct protection on shareholders[13] and that there was a body of general arbitral jurisprudence arising from the interpretation of such treaties which give support to shareholders' claims,[14] this did not provide evidence of a rule of customary international law in favour of the right of the State(s) of nationality of shareholders to exercise diplomatic protection on their behalf. All these practices and treaties were dismissed as *lex specialis*.

7. The Court accepted that the State(s) of nationality of shareholders might exercise diplomatic protection on their behalf in two situations: first, where the company had ceased to exist in its place of incorporation[15] — which was not the case with the Barcelona Traction; secondly, where the State of incorporation was itself responsible for inflicting injury on the company and the foreign shareholders' sole means of protection on the international level was through their State(s) of nationality[16] — which was not the case with Barcelona Traction. (Consequently, the Court declined to give endorsement to this exception.)[17]

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[5] *1970 I.C.J. Reports*, p. 34, para. 40.
[6] Ibid., p. 34, para. 41.
[7] Ibid., p. 35, para. 44.
[8] Ibid., p. 36, para. 47.
[9] Ibid., p. 37, para. 50.
[10] Ibid., p. 42 (para. 70), p. 46 (para. 88).
[11] Ibid., p. 39, para. 60.
[12] Ibid., p. 40, para. 61.
[13] Ibid., p. 47, para. 90.
[14] Ibid., p. 40, para. 63.
[15] Ibid., pp. 40-41, paras. 65-68.
[16] Ibid., p. 48, para. 92.
[17] Loc. cit.

8. Suggestions that the protection of shareholders might be allowed on grounds of equity were dismissed by the Court in the circumstances of the case before it.[18] The Court also declined to recognize the existence of a secondary right of diplomatic protection attaching to the State(s) of nationality of shareholders where, as in the present case,[19] the State of incorporation declined to exercise diplomatic protection on behalf of the company.[20]

9. The argument that the decision of the International Court in the *Nottebohm* case,[21] requiring the existence of a genuine link between an injured individual and the State of nationality seeking to protect him, might be applied to corporations, with the consequence that Belgium, with which Barcelona Traction was most genuinely linked by virtue of its nationals holding 88 percent of the shares in the company, was the appropriate State to exercise diplomatic protection, was not accepted. The Court did not, however, dismiss the application of the genuine link test to corporations, as it held that *in casu* there was "a close and permanent" link between Barcelona Traction and Canada as it had its registered office there and had held its board meetings there for many years.[22]

10. In reaching its decision that the State of incorporation of a company and not the State(s) of nationality of the shareholders in the company is the appropriate State to exercise diplomatic protection in the event of injury to a company, the Court was guided by a number of policy considerations. First, when shareholders invest in a corporation doing business abroad they undertake risks, including the risk that the corporation may in the exercise of its discretion decline to exercise diplomatic protection on their behalf.[23] Secondly, if the State of nationality of shareholders is permitted to exercise diplomatic protection, this might lead to a multiplicity of claims by different States, as frequently large corporations comprise shareholders of many nationalities.[24] In this connection the Court indicated that if the shareholder's State of nationality was empowered to act on his behalf there was no reason why every individual shareholder should not enjoy such a right.[25] Thirdly, the Court was reluctant to apply by way of analogy rules relating to dual nationality to corporations and shareholders and to allow the States of nationality of both to exercise diplomatic protection.[26]

*Separate opinions*

11. Although the Belgian Government's claim was dismissed by 15 votes to 1 (the Belgian judge ad hoc, Riphagen), there was widespread disagreement among judges over the reasoning of the Court in *Barcelona Traction*. This was evidenced by the fact that 8 of the 16 judges gave separate opinions, of which 5 (including Judge ad

[18] Ibid., p. 48 (paras. 92, 93), p. 50 (para. 101).

[19] For a number of reasons, including the absence of a treaty between Canada and Spain conferring jurisdiction on the International Court of Justice, Canada declined to institute proceedings on behalf of Barcelona Traction. See ibid., p. 45, paras. 81-83.

[20] Ibid., p. 49, para. 96.

[21] *1955 I.C.J. Reports*, p. 4.

[22] *1970 I.C.J. Reports*, p. 42, paras. 70-71.

[23] Ibid., p. 35 (para. 43), p. 46 (paras. 86-87), p. 50 (para. 99).

[24] Ibid., pp. 48-49, paras. 94-96.

[25] Ibid., p. 48, paras. 94-95.

[26] Ibid., p. 38 (para. 53), p. 50 (para. 98).

hoc Riphagen) supported the right of the State of nationality of the shareholders to afford diplomatic protection.

12. Judge Tanaka found that "customary international law does not prohibit protection of shareholders by their national State even when the national State of the company possesses the right of protection in respect of the latter."[27] He added that:

> "It is true that there is no rule of international law which allows two kinds of diplomatic protection to a company and its shareholders respectively, but there is no rule of international law either which prohibits double protection."[28]

Although Judges Fitzmaurice, Jessup and Gros did not go as far as Judge Tanaka, they were patently in disagreement with the philosophy and reasoning of the majority judgment and held that in certain circumstances, particularly where the State of nationality of the corporation was the wrongdoing State,[29] the State of nationality of the shareholders had the right to exercise diplomatic protection. Judge Gros moreover accused the Court of being blind to the realities of modern investment:

> "The foundation of a rule of economic international law must abide by economic realities. The company's link of bare nationality may not reflect any substantial economic bond. As between the two criteria the judge must choose the one on the test of which the law and the facts coincide: it is the State whose national economy is in fact adversely affected that possesses the right to take legal action."[30]

13. In contrast, Judges Morelli,[31] Padilla Nervo[32] and Ammoun[33] were not only supportive of the Court's reasoning but rejected suggestions that the State of nationality of the shareholders might take action where the State of nationality of the corporation was the wrongdoing State. Judge Padilla Nervo spoke for developing States when he declared:

> "It is not the shareholders in those huge corporations who are in need of diplomatic protection; it is rather the poorer or weaker States, where the investments take place, who need to be protected against encroachment by powerful financial groups, or against unwarranted diplomatic pressure from Governments who appear to be always ready to back at any rate their national shareholders ..."[34]

*Criticism of the Court's judgment*

14. The decision of the International Court of Justice in *Barcelona Traction* has been subjected to a wide range of criticisms. The following are some of the criticisms that should be taken into consideration in the search for the formulation of a satisfactory rule on the subject of diplomatic protection of corporations and/or shareholders.

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[27] Ibid, p. 134. See also p. 130.
[28] Ibid., p. 131.
[29] Judge Fitzmaurice, ibid., pp. 72-75; Judge Jessup, ibid., pp. 191-194.
[30] Ibid., p. 279.
[31] Ibid., pp. 240-241.
[32] Ibid., p. 257.
[33] Ibid., p. 318.
[34] Ibid., p. 248.

15. The rule expounded in *Barcelona Traction* is derived from general principles of corporation law recognized by civilized nations rather than from customary international law. Had the Court had regard to State practice expressed in bilateral and multilateral investment treaties and lump sum settlement agreements and to arbitral decisions interpreting such treaties, instead of dismissing such treaties as *lex specialis*, it might have found sufficient evidence of a rule of customary international law in favour of shareholders' claims. According to Richard Lillich, the Court summarily rejected "as irrelevant the bulk of traditional international practice governing shareholder claims" and missed "an excellent opportunity to place its judicial imprimatur upon a developing rule of customary international law with respect to shareholders' claims" by opting "to refer exclusively to the municipal law of corporations, under which a wrong inflicted upon a corporation generally does not give rise to an enforceable right in the hands of its shareholders."[35] In directing this criticism at the Court, Lillich echoed the statement of Judge Wellington Koo when the *Barcelona Traction* case first came before the International Court in 1964:

> "[T]here is seen a substantial body of evidence of State practice, treaty arrangements and arbitral decisions to warrant the affirmation of the inexplicit existence of a rule under international law recognizing such a right of protection on the part of any State of its nationals, shareholders in a foreign company, against another wrongdoing State, irrespective of whether that other State is the national State of the company or not, for injury sustained by them through the injury it has caused to the company."[36]

16. *Barcelona Traction* established "an unworkable standard".[37] In practice States will not exercise diplomatic protection merely on the basis of incorporation, that is, in the absence of some genuine connection arising from substantial national shareholding in the corporation. It is unrealistic to expect a State to expend time, energy, money and political influence on a corporation injured abroad when it has no material connection with the corporation. Conversely, it is unrealistic to expect a respondent State to accept such a minor link as incorporation as constituting the "genuine link" necessary to confer standing to present an international claim. This explains why in practice many States have indicated that they will not exercise diplomatic protection on behalf of a corporation with which they do not have a connection[38] in the nature of economic control (dominant shareholding or beneficial ownership), *siège social* (headquarters or centre of administration) or a combination of both. The practice of the post-*Barcelona Traction* era shows that States adopt a variety of approaches in deciding whether to espouse the claim of a company against

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[35] "The Rigidity of Barcelona" (1971) 65 *A.J.I.L.* 522 at 525, 531. See also R. Higgins "Aspects of the Case Concerning the Barcelona Traction, Light and Power Company, Ltd." (1971) 11 *Virginia Journal of International Law* 327, 331; "Round Table: Toward More Adequate Diplomatic Protection of Private Claims: 'Aris Gloves', 'Barcelona Traction' and Beyond" (1971) 65 *American Society of International Law, Proceedings*, 322, 343 (Domke), 344 (Weston), 345 (Caflisch).

[36] *Barcelona Traction, Light and Power Co., Ltd. Case* (Preliminary Objections) *1964 I.C.J. Reports*, p. 63.

[37] Stanley D. Metzger "Nationality of Corporate Investment under Investment Guarantee Schemes -- The Relevance of Barcelona Traction" (1971) 65 *A.J.I.L.* 532, 541.

[38] See the table attached to Metzger's article, ibid., 542-543, showing that in order for a corporation to be eligible for investment guarantee schemes States usually require some substantial link between State and corporation.

another State.[39] Some, such as the United Kingdom of Great Britain and Northern Ireland[40] and the United States of America,[41] require a real and substantial connection with the corporation, while others emphasize the *siège social* or economic control. In summary, tests such as control, *siège social* or majority shareholding, which emphasize the genuine connection between the State exercising diplomatic protection and the company, enjoy greater support than the slender and neutral link of incorporation.

17. Support for the criticism in the preceding paragraph is to be found in the subsequent practice of States in respect of lump sum agreements and investment treaties. In their interim reports to the Committee on Diplomatic Protection of Persons and Property of the International Law Association at its New Delhi Conference in 2002,[42] both Professors David Bederman and Julianne Kokott stressed that States have deliberately regulated their affairs in order to avoid the ruling of the International Court in *Barcelona Traction*.

In his interim report on "Lump Sum Agreements and Diplomatic Protection", Bederman shows that the eligibility of corporations to claim under such agreements post-*Barcelona Traction* is based more frequently on the whereabouts of the headquarters of the company (*siège social*), control or preponderance of shareholding than on mere incorporation.[43] Moreover, shareholders are generally allowed to claim in terms of such agreements which sanction the settlements of claims for property, rights, interests and claims adversely affected by the respondent State.[44] This leads him to conclude that "the eligibility standards for corporations and their shareholders appear to have been relaxed substantially, and so the substantive holding in *Barcelona Traction* may now well be cast in doubt (at least as reflected in lump sum agreements)".[45]

Kokott's interim report on "The Role of Diplomatic Protection in the Field of the Protection of Foreign Investment" adopts a similar approach. She shows that the discretionary nature of diplomatic protection and the restrictive rule laid down in *Barcelona Traction* have prompted States to resort to bilateral investment treaties (BITS),[46] which allow investors to settle their investment disputes with the host State before ad hoc arbitration tribunals or the International Centre for Settlement of Investment Disputes (ICSID), established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.[47] She concludes:

> "There is no need to go so far as to say that diplomatic protection and the rules governing the protection of foreign investment exclude each other. However, the result might well appear disappointing from the perspective of somebody who wants to argue that diplomatic protection should play a strong role in today's law of foreign investment. The analysis of the BIT regime as

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[39] Ian Brownlie, *Principles of Public International Law*, 5th ed. (1998), pp. 487-489.

[40] See the British rules applying to international claims of 1985, reproduced in (1988) 37 *I.C.L.Q.* 1006, 1007 (comment on rule IV).

[41] See the statement of the United States representative of the Sixth Committee on 1 November 2002, A/C.6/57/SR.23, paras. 50-56.

[42] International Law Association, *Report of the Seventieth Conference, New Delhi* (2002), p. 228.

[43] Ibid., pp. 252-253.

[44] Ibid., pp. 253-255.

[45] Ibid., p. 258.

[46] Ibid., p. 265.

[47] United Nations, *Treaty Series*, vol. 575, p. 159; (1965) 4 *I.L.M.* 524.

well as multilateral approaches has shown that diplomatic protection does not play a major role among the available means of dispute resolution. Generally speaking, the agreements, both bilateral and multilateral, prefer alternative dispute resolution procedures and allow investors to access international arbitration bodies. This way gives them standing under international law and circumvents diplomatic protection. This report shows that this development offers a number of advantages, compared to the need to resort to a home State's willingness (or ability) to exercise diplomatic protection.

"There appears to be a strong sentiment of distrust towards diplomatic protection — as regards its political uncertainties, its discretionary nature and its ability to protect foreign shareholders under the ICJ's doctrine. What is the consequence? There appear to be two different options. One of them might be a call for a change of the rules governing diplomatic protection with the aim of meeting the demands of investors. However, this option does not seem to be realistic because it neglects the existence of a network of bilateral agreements, accompanied by multilateral agreements. Sooner or later, a successor of the Multilateral Agreement on Investment will come into existence. Based on these considerations, a second option is more realistic: to accept that, in the context of foreign investment, the traditional law of diplomatic protection has been to a large extent replaced by a number of treaty-based dispute settlement procedures."[48]

18. The Court's handling of the relevance of the *Nottebohm* case[49] to the diplomatic protection of companies is far from satisfactory.[50] On the one hand, the judgment appears to reject the application of the "genuine link" to companies by its findings that "in the particular field of the diplomatic protection of corporate entities, no absolute test of 'genuine connection' has found general acceptance"[51] and that there was no analogy between the issues raised in *Barcelona Traction* and *Nottebohm*. On the other hand, the Court examines the links between the *Barcelona Traction* and Canada — incorporation, registered office, accounts, share registers, board meetings and listing with the Canadian tax authorities — and concludes that "a close and permanent connection has been established" between Canada and the company.[52]

19. The relevance of the *Nottebohm* "genuine link" to corporations is confirmed by the separate opinions of Judges Fitzmaurice,[53] Jessup,[54] Padilla Nervo[55] and Gros.[56] On the basis of the Court's finding that there was "a close and permanent

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[48] Interim report, supra note 42, at pp. 276-277; see also S. D. Murphy "The ELSI Case: an Investment Dispute at the International Court of Justice" (1991) 16 *Yale Journal of International Law* 391, 392.

[49] *1955 I.C.J. Reports*, p. 4.

[50] Brownlie, supra note 39; Arthur Watts, "Nationality of Claims: Some Relevant Concepts" in: *Fifty Years of the International Court of Justice. Essays in Honour of Sir Robert Jennings* (eds. V. Lowe and M. Fitzmaurice), p. 424 at pp. 432-433.

[51] *1970 I.C.J. Reports*, p. 42, para. 70.

[52] Ibid., p. 42, para. 71.

[53] Ibid. p. 80.

[54] Ibid, p. 186.

[55] Ibid. p. 254.

[56] Ibid. p. 281.

connection" between Canada and the company, F. A. Mann[57] has suggested that the Court found that the State of the shareholders' nationality may have a right of protection where the State of incorporation lacks the capacity to act on behalf of the company because of an insufficient connection with the company.

20. The Court in *Barcelona Traction* acknowledged that the shareholders' national State might extend diplomatic protection to it in three situations: first, where the direct rights of the shareholders are infringed;[58] secondly, where the company ceases to exist;[59] and thirdly, possibly, where the State of nationality of the corporation is the wrongdoing State.[60] None of these exceptions to the rule it expounds in favour of diplomatic protection by the State of incorporation of the company is properly considered.[61] Weaknesses in the Court's reasoning on this matter will be considered below when rules allowing the diplomatic protection of shareholders are considered.

21. Finally, the Court fails to justify adequately its reasoning on issues of policy described above in paragraph 10. Why should shareholders that invest in a corporation doing business abroad be expected to bear the risk that their investment will fail? The existence of bilateral investment treaties designed to protect foreign investment seems to contradict this philosophy.[62] Why should the prospect of a multiplicity of claims by shareholders against a wrongdoing State create an atmosphere of confusion and insecurity in international economic relations?[63] Why should the rules of dual protection applicable to individuals and to international organizations[64] not apply equally to corporations and shareholders? It is not sufficient simply to argue that there is no analogy between the two.[65]

*The Authority of* Barcelona Traction

22. Decisions of the International Court of Justice are not binding on the International Law Commission. Although there is an understandable reluctance on the part of the Commission to reject such decisions, it must be recalled that it has in recent years severely limited the scope of a major decision of over 40 years' standing — the *Nottebohm* case[66] — and expressly rejected another of over 30 years' standing — the *South West Africa Cases (Second Phase)*.[67] *Barcelona Traction* is not sacrosanct, untouchable. The Commission may therefore, after careful consideration, decide not to follow it. Such a decision might be based on criticisms of the kind described above levelled at the decision; on the apparent

[57] "The Protection of Shareholder's Interests in the Light of the Barcelona Traction Case" (1973) 67 *A.J.I.L.* 259, 264, 269, 273.

[58] *1970 I.C.J. Reports*, p. 36, para. 47.

[59] Ibid., pp. 40-41, paras. 64-68.

[60] Ibid., p. 48, para. 92.

[61] Mann, supra, note 57, at 265-272.

[62] See the separate opinion of Judge Gros, *1970 I.C.J. Reports*, p. 275.

[63] Ibid., p. 49, para. 96.

[64] *Reparation for Injuries Suffered in the Service of the United Nations, 1949 I.C.J. Reports*, p. 185.

[65] *1970 I.C.J. Reports*, p. 38, para. 53.

[66] *1955 I.C.J. Reports*, p. 4. *Official Records of the General Assembly, Fifty-seventh session, Supplement No. 10* (A/57/10), para. 280, commentary to article 3 [5].

[67] *1966 I.C.J. Reports*, p. 6. *Official Records of the General Assembly, Fifty-sixth session, Supplement No. 10*, and corrigendum (A/56/10 and Corr.1), para. 77, commentary to article 48, footnote 766.

failure of the International Court thoroughly to debate the issues involved;[68] or on the fact that the Court was not codifying international law but resolving a particular dispute, with the result that its "rule" is to be seen as a judgement on particular facts and not as a general rule applicable to all situations. The last reason for declining to follow *Barcelona Traction* receives some support from the decision of a Chamber of the International Court of Justice itself in the *ELSI* case.[69]

*The* ELSI *case*

23. Although *Barcelona Traction* rules that a State whose nationals hold the majority of shares in a company may not present a claim for damage suffered to the company itself, in the *Case Concerning Elettronica Sicula S.p.A. (ELSI)*, a Chamber of the International Court of Justice allowed the United States to bring a claim against Italy in respect of damage suffered by an Italian company whose shares were wholly owned by two American companies. (The Chamber, however, rejected the United States claim on the merits, in that on the facts of the case Italy's conduct did not constitute a breach of the Treaty of Friendship, Commerce and Navigation in question.) Surprisingly, the Chamber avoided pronouncing on the compatibility of its finding with that of *Barcelona Traction* despite the fact that Italy formally objected that the company whose rights were alleged to have been violated was Italian, and the United States sought to protect the rights of shareholders in the company.[70]

24. That *Barcelona Traction* was relevant to *ELSI* was emphasized by Judge Oda who, in a separate opinion, argued that the American companies which owned the Italian company were mere shareholders of the Italian company, with the result that the United States could not offer them diplomatic protection.[71] It is generally agreed that the Chamber by its silence did not accept this argument — despite the fact that it is based on *Barcelona Traction*.[72]

25. *ELSI*'s failure to distinguish *Barcelona Traction* can be explained on a number of grounds.[73] First, the Chamber of the Court was not here concerned with an evaluation of customary international law (as in *Barcelona Traction*), but with the interpretation of a Treaty of Friendship, Commerce and Navigation which, like a bilateral investment treaty, provided for the protection of United States shareholders abroad. Had the Chamber found the United States claim inadmissible on the ground that the United States might not protect American companies holding shares in an Italian company, this would have imperilled the value of bilateral investment treaties

[68] See the criticism of the discussions in the Court in *Barcelona Traction* in the separate opinion of Judge Fitzmaurice, *1970 I.C.J. Reports*, p. 86, para. 37.

[69] *1989 I.C.J. Reports*, p. 15.

[70] Ibid., paras. 64, 79.

[71] Ibid., pp. 87-88.

[72] See the dissenting opinion of Judge Schwebel, ibid., p. 94; *Oppenheim's International Law*, 9th ed. (eds. R. Jennings and A. Watts) vol. 1, p. 520. S. D. Murphy, "The ELSI Case: an Investment Dispute at the International Court of Justice" (1991) 16 *Yale Journal of International Law* 391, 420; R. McCorquodale "Expropriation Rights under a Treaty — Exhausted and Naked" (1990), *Cambridge Law Journal 197, 199*; S. A. Kubiakowski, "The Case of ELSI: Towards Greater Protection of Shareholders' Rights in Foreign Investments" (1991) 29 *Columbia Journal of Transnational Law* 215, 234; F. A. Mann, "Foreign Investment in the International Court of Justice" (1992) 86 *A.J.I.L.* 92.

[73] See, generally, on this decision, Brigitte Stern, "La Protection diplomatique des investissements internationaux" (1990) 116 *Journal de droit international* 897.

which, inter alia, aim to protect national shareholders that control companies incorporated in the host State of the investment.[74] Secondly, this case possibly involved the infringement of the direct rights of shareholders — an exception recognized by *Barcelona Traction*.[75] Thirdly, it might have been argued that this was a case in which the company had ceased to exist because it had gone into liquidation — another exception to the general rule recognized by *Barcelona Traction*. Fourthly, it may be contended[76] that in this case the Chamber gave an affirmative answer to the question left open in *Barcelona Traction*, whether the shareholders' national State might protect them when the company was injured by the State of incorporation.

26. Although the failure of *ELSI* to apply the rule expounded in *Barcelona Traction* may be explained, the incontestable fact is that the Chamber declined to follow the rule, reasoning and philosophy of *Barcelona Traction*. Understandably, it has been hailed as a retreat from *Barcelona Traction*.[77]

Barcelona Traction *thirty years on*

27. *Barcelona Traction* is undoubtedly a significant judicial decision, albeit one whose significance is not matched either by the persuasiveness of its reasoning or by its concern for the protection of foreign investment. The International Law Commission might therefore feel compelled to depart from it and to formulate a rule that accords more fully with the realities of foreign investment and encourages foreign investors to turn to the procedures of diplomatic protection for redress rather than to the protection of bilateral investment treaties. On the other hand, it must be acknowledged that, despite its shortcomings, *Barcelona Traction* is today, 30 years on, widely viewed not only as an accurate statement of the law on the diplomatic protection of corporations but as a true reflection of customary international law. The practice of States in the diplomatic protection of corporations is today guided by *Barcelona Traction*.[78] This was clearly demonstrated by the response of delegates in the Sixth Committee to the question whether the rule in *Barcelona Traction* should be reconsidered.[79] Of the 15 delegates who spoke on this subject,

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[74] Terry Gill, "ELSI Case", in (1990) 84 *A.J.I.L.* 249, 257-258. See also Mann, supra note 72.

[75] *1970 I.C.J. Reports*, p. 36, para. 47. See further on this: Vaughan Lowe, "Shareholders' Rights to Control and Manage: From Barcelona Traction to ELSI", in *Liber Amicorum Judge Shigeru Oda*, eds. N. Ando et al (2002), p. 269. See also Arthur Watts "Nationality of Claims: Some Relevant Concepts", in *Fifty Years of the International Court of Justice. Essays in Honour of Sir Robert Jennings* (1996) (eds. V. Lowe and M. Fitzmaurice), p. 424 at p. 435 (footnote 56).

[76] Yoram Dinstein, "Diplomatic Protection of Companies under International Law", in *International Law: Theory and Practice* (1998) (ed. K. Wellens), p. 505 at p. 512.

[77] Murphy, supra note 72.

[78] See the rules issues by the British Government in 1987, published in (1988) 37 *I.C.L.Q.* 1006. Rule IV, in providing that the United Kingdom may take up the claim of a company incorporated in the United Kingdom, expressly states, in the commentary thereto, that it is founded on *Barcelona Traction*.

[79] The following questions were put to States on this subject: "In the *Barcelona Traction* case, the International Court of Justice held that the State in which a company is incorporated and where the registered office is located is entitled to exercise diplomatic protection on behalf of the company. The State of nationality of the shareholders is not entitled to exercise diplomatic protection, except, possibly, where:

(a) The shareholders' own rights have been directly injured;

(b) The company has ceased to exist in its place of incorporation;

only one[80] suggested that *Barcelona Traction* should be reconsidered. Regrettably all but one of the delegates who spoke on this subject represented developed States. However, it is unlikely that developing States would show much enthusiasm for a rule replacing *Barcelona Traction* that accords more protection to shareholders of foreign companies.[81] The writings of the most highly qualified publicists, to use the language of Article 38 (1) (d) of the Statute of the International Court of Justice, do not, in general, display an uncritical acceptance of *Barcelona Traction*. They do, however, treat it as the seminal decision on the diplomatic protection of corporations, the starting point of any discussion on the subject.[82]

### 3. Options open to the Commission

28. Before proposing the formulation of a rule or rules on the subject of the nationality of corporations and the diplomatic protection of companies and/or shareholders, the Special Rapporteur considers it necessary to clarify the options open to the Commission. They are:

(1) The State of incorporation, subject to the exceptional circumstances envisaged by *Barcelona Traction* for the protection of shareholders;

(2) The State in which the company is incorporated and with which it has a genuine connection (usually in the form of economic control), again subject to the exceptional cases envisaged by *Barcelona Traction* for the protection of shareholders;

(3) The State of the *siège social* or domicile;

(4) The State in which the economic control of the company is located;

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(c) The State of incorporation is the State responsible for the commission of an internationally wrongful act in respect of the company.

Should the State of nationality of the shareholders be entitled to exercise diplomatic protection in other circumstances? For instance, should the State of nationality of the majority of shareholders in a company have such a right? Or should the State of nationality of the majority of the shareholders in a company have a secondary right to exercise diplomatic protection?" *Official Records of the General Assembly, Fifty-seventh session, Supplement No. 10* (A/57/10), para. 28.

[80] Germany described the decision in *Barcelona Traction* as "unsatisfactory" and urged the grant of a subsidiary right of protection to shareholders (see, generally, A/C.6/57/SR.20, paras. 25-26). The United States, while supporting *Barcelona Traction*, stated that it takes the nationality of shareholders into account in deciding whether to exercise diplomatic protection, and urged that shareholders be protected where the State of nationality is itself responsible for injury to the company (A/C.6/57/SR.23, para. 52).

[81] G. Abi-Saab, "The International Law of Multinational Corporations: A Critique of American Legal Doctrines" (1971) *Annales d'études internationales* 97, 121-122.

[82] R. Jennings and A. Watts (eds.), *Oppenheim's International Law*, 9th ed. (1992) vol. 1, pp. 515-522; P. Daillier and A. Pellet (eds.), *Nguyen Quoc Dinh's Droit International Public*, 6th ed. (1999), p. 773; M. N. Shaw, *International Law*, 4th ed. (1997), p. 566; I. Brownlie, *Principles of Public International Law*, 5th ed. (1998), pp. 491-495; P. H. Kooijmans, *Internationaal Publiekrecht in Vogelvlucht*, 9th ed. (2002), p. 116; I. A. Shearer (ed.), *Starke's International Law*, 11th ed. (1994) pp. 286-287; L. C. Caflisch "The Protection of Corporate Investments Abroad in the Light of the Barcelona Traction Case" (1971) 31 *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* 162, 196.

(5) Both the State of incorporation and the State of economic control. This would permit a form of dual protection similar to that which applies in the case of dual nationality of natural persons;

(6) The State of incorporation in the first instance, with the State of economic control enjoying a secondary right of protection in the event of failure on the part of the State of incorporation to exercise protection;

(7) The States of nationality of all shareholders.

These options will be considered in greater detail below.

*Option 1: The State of incorporation*

29. The State in which the company is incorporated alone has the right to exercise diplomatic protection in respect of an injury to the company, subject to the exceptions expounded in *Barcelona Traction* in which the State of nationality of the shareholders of the company may exercise diplomatic protection on their behalf. This option may be described as the Rule in *Barcelona Traction*. The advantages and disadvantages of such a rule have been considered above.

*Option 2: The State of incorporation and the State of genuine link*

30. The State in which the company is incorporated *and* with which it enjoys a "genuine link" of the kind described in *Nottebohm* may exercise diplomatic protection on behalf of the company, subject to the exceptions in favour of shareholders' claims recognized in *Barcelona Traction*. To some extent such a proposal reflects State practice because many States will not exercise diplomatic protection on behalf of a company with which they do not have a genuine connection, in the form of dominant shareholding, economic control or *siège social*.[83] The main disadvantage of such a rule is that many companies are incorporated in States with which they have no real connection, in order to secure tax advantages. Such companies will, for the purposes of diplomatic protection, be rendered stateless. This consequence did not seem to trouble Judges Padilla Nervo,[84] Petrén or Onyema.[85] On the other hand, it would clearly run counter to the reasoning of the Court in *Barcelona Traction*, which was premised on the notion that one State — Canada — had the right to protect the company,[86] and to "the current trend of international law, which is towards greater protection of the rights of individuals."[87] Another difficulty with such a rule is that raised by Christopher Stalker:

> "The existence of a genuine link would also give rise to the question of the point in time at which the genuine link must exist. Is a genuine link with the

[83] See further D. Harris, "The Protection of Companies in International Law in the Light of the Nottebohm Case", (1969) 18 *I.C.L.Q.* 275.

[84] *1970 I.C.J. Reports*, p. 254.

[85] See Joint Declaration by Judges Petrén and Onyema, ibid., p. 52.

[86] See Judgment, ibid., para. 94, where the Court states: "Consideration of equity cannot require more than the possibility for some protector State to intervene ..." See also the Declaration by Judge Lachs, ibid., p. 52, where he states that the existence of Canada's right to protect the company "is an essential premise of the Court's reasoning."

[87] Christopher Stalker, "Diplomatic Protection of Private Business Companies: Determining Corporate Personality for International Law Purposes", (1990) 61 *British Year Book of International Law*, 157, 159.

State of incorporation required only at the time of incorporation or only at the time that its existence is in issue (so that it will be recognized if there is a genuine link at the time of injury and of the bringing of the claim, even if there was none at the time of actual incorporation), or is a genuine connection required continuously from the time of incorporation to the bringing of the claim?"[88]

*Option 3: The State of the* siège social *or domicile*

31. There is support among the authorities for the view that a corporation should take the nationality of its *siège social*[89] or place of domicile, tests normally employed by civil law (*siège social*) and common law (domicile) countries to link a corporation with a State for the purposes of the conflict of laws.[90] Doubts have been expressed as to whether it would be appropriate to apply such *private* law tests to a problem of *public* international law.[91] In addition, as the decisions of arbitral tribunals have shown, there is usually a close correlation between *siège social* or domicile and the place of incorporation.[92]

*Option 4: The State of economic control*

32. There is considerable support for the position that the State of economic control should be entrusted with the role of diplomatic protection. Unfortunately this view draws heavily for support on legislation and decisions, mainly after the First World War, which employed the test of *effective* control for determining the enemy character of corporations.[93] As D. P. O'Connell states, "as an analogue for purposes of determining diplomatic protection, the theory of control for purposes of economic warfare is practically valueless",[94] a view shared by the International Court in *Barcelona Traction*.[95]

33. Despite this misplaced analogy there are sound reasons for proposing the State of *economic* control as the State entitled to exercise diplomatic protection. It accords more with the economic realities of foreign investment, in which the State of

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[88] Ibid., 163.

[89] *1970 I.C.J. Reports*, p. 42, para. 70.

[90] D. P. O'Connell, *International Law*, 2nd ed. (1970), vol. II, p. 1041; L. Levy, *La Nationalité des sociétés* (1984), pp. 183-196; Harris, supra note 83, at 295-301.

[91] Ibid., pp. 1041-1042.

[92] This is the conclusion reached by Georg Schwarzenberger, *International Law*, vol. 1, 3rd ed. (1957), pp. 393-397, after an examination of the *Canevaro* case (Italy v. Peru), Scott, *Hague Court Reports*, vol. 1, p. 284; *La Suédoise Grammont v. Roller*, *Mixed Arbitration Tribunals*, vol. 3, p. 570; *Mexico Plantagen G.m.b.H., Annual Digest and Reports of Public International Law Cases*; 1931-32, Case No. 135; *F. W. Flack (G. B.) v. United Mexican States* 5 *U.N.R.I.A.A.*, p. 61 (1929); *Madera Company Claim*, ibid., p. 156 (1929); *Interoceanic Railway of Mexico*, ibid., p. 178 (1931).

[93] Ignaz Seidl-Hohenveldern *Corporations in and Under International Law* (1987), pp. 27-29; A. McNair and A. Watts *Legal Effects of War*, 4th ed. (1960); *Daimler Co. v. Continental Tyre and Rubber Co.* [1916] 2 A.C. 307. A similar test has also been employed by the United Nations in respect of its resolution imposing economic sanctions against Libya, Security Council resolution 883 (1993) of 11 November 1993. See further the discussion of the resolution by Special Rapporteur V. Mikulka in the fourth report on nationality in relation to the succession of States, *Yearbook ... 1998*, vol. II (Part One), document A/CN.4/489, paras. 15-17.

[94] *International Law*, 2nd ed. (1970), p. 1042.

[95] *1970 I.C.J. Reports*, p. 39, para. 60.

nationality of shareholders will usually have a greater interest in securing reparation than the State of incorporation, which, as in the case of Canada in the *Barcelona Traction* proceedings, may only have a marginal interest in obtaining redress. The ever-present threat in this branch of the law that the State will decline to exercise diplomatic protection in the exercise of its discretion is thereby substantially reduced. Acceptance of the State of economic control as the protector of the corporation will constitute recognition of the importance of an effective or genuine link between the protecting State and the injured legal person — a consideration in respect to which the Court was sensitive in *Barcelona Traction*.[96] Moreover, by limiting diplomatic intervention to one State, this test avoids the problem of a multiplicity of claims that might arise if the State of nationality of every shareholder were permitted to exercise diplomatic protection. Human rights considerations also support the economic control test, as the foreign investor should not be without a claim to protection.

34. Defining control is not an easy task, as has been observed by legal scholars.[97] Two standards compete for acceptance here: majority shareholding, that is, ownership of more than 50 per cent of the shares, and preponderance of shares. If the former standard is accepted, the rule may create a stateless corporation in respect of which no State might make a claim. Thus the test of preponderance, which would give to the State whose nationals hold the greatest number of shares in the company the right to exercise diplomatic protection, is to be preferred. Alternatively a test might be formulated which takes account of both majority shareholders and a preponderance of shares in assessing control. Francisco Orrego Vicuna, in his interim report on "The Changing Law of Nationality of Claims" to the International Law Association Committee on Diplomatic Protection of Persons and Property, has suggested that a rule in favour of diplomatic protection for the State of control might be drafted as follows:

> "Control of a foreign company by shareholders of a different nationality, expressed in a 50 per cent ownership of its capital stock or such other proportion needed to control the company, may entitle the State of nationality of such shareholders to exercise diplomatic protection on their behalf or otherwise to consider the company as having its nationality."[98]

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[96] Ibid., p. 42, paras. 70-71.

[97] I. Brownlie, *Principles of Public International Law*, 5th ed. (1998), p. 487; O'Connell, supra note 90, at p. 1042; L. Levy, supra note 90, at pp. 200-224.

[98] ILA Report of the 69th Conference, London (2000), p. 647.

State practice is not uniform. Some treaties define control in terms of majority shareholding.[99] Others simply refer to control and leave it to the relevant tribunal to determine this requirement in all the circumstances, including shareholding.[100]

35. Economic control as the test for the nationality of a corporation for the purposes of diplomatic protection is open to several criticisms in addition to that of imprecision in relation to the concept of control. It will inevitably present problems of proof, both in respect of fact and in respect of law. *Barcelona Traction* itself shows how difficult it is to identify with certainty the shareholding of a company.[101] In addition there are problems of burden of proof[102] and presumptions of evidence that are likely to further complicate control,[103] whether in the form of a majority of shareholding or of a preponderance of shareholding, as the acceptable standard for the diplomatic protection of corporations.

36. For the Commission the adoption of a rule in favour of economic control presents serious difficulties. While it may be true that before *Barcelona Traction* it enjoyed more support than the test of incorporation,[104] it is doubtful whether it then represented a rule of customary international law. A fortiori its status is today weaker as a customary rule after 30 years of living with *Barcelona Traction*. Bilateral investment treaties may, in the meantime, have given support to the notion of shareholder protection but these treaties are themselves not uniform in respect of the subject of protection. [Moreover, in the years since *Barcelona Traction* these treaties have been seen as belonging to the realm of *lex specialis* and therefore have

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[99] See the Algiers Declaration of 1981, providing for the settlement of U.S.-Iran Claims (1981), 20 I.L.M. 230, which includes as nationals corporations organized under the laws of either country if nationals of such country directly or indirectly hold an interest in the corporation "equivalent to 50 per cent or more of its capital stock" (article VII (1)). See, on the application of this provision: *Sola Tiles Inc. v. Government of the Islamic Republic of Iran*, 83 I.L.R. 460, 465-467; *Morrisen-Knudsen Pacific Ltd. v. Ministry of Roads and Transportation* (1985) 79 *A.J.I.L.* 146; *Sedco Inc. v. National Iranian Oil and Islamic Republic of Iran* 84 I.L.R. 484; *Starrett Housing Corporation v. Government of the Islamic Republic of Iran* (1984) 23 *I.L.M.* 1090, 1106. See also the 1973 United States-Peru Agreement on Settlement of Certain Claims; article 1: (1974) 68 *A.J.I.L.* 538; Convention establishing the United Kingdom-Mexican Claims Commission, *United Kingdom Treaty Series* No. 11, 1928, article 3.

[100] Article VII (2) of the Algiers Declaration, supra note 99, defines claims of nationals of the United States as "claims that are owned indirectly by such nationals through ownership of capital stock or other proprietary interest in juridical persons, provided that the ownership interests of such nationals, collectively, were sufficient at the time the claims arose to control the corporation or other entity and provided further that the corporation or other entity is not itself entitled to bring a claim under the terms of this Agreement." See on the interpretation of this provision: *R. N. Pomeroy v. Government of the Islamic Republic of Iran*, 2 Iran-U. S. Cl. Trib. Rep. 391, 395-396; *Alcan Aluminium Ltd v. Ircable Corporation*, 72 I.L.R. 725 (claimants failed as they were unable to show that they owned more than 50 per cent of Alcan's shares). See further C. N. Brower and J. D. Brueschke, *The Iran-U.S. Claims Tribunal* (1998), pp. 45-51; G. H. Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal* (1996), pp. 47-54.

[101] *1970 I.C.J. Reports*, pp. 219-220 (Judge Jessup). See also cases before the Iran-U.S. Claims Tribunal: *Alcan Aluminium Ltd. v. Ircable Corporation*, 72 I.L.R. 725, 129; *Sedco Inc. v. National Iranian Oil Co. and the Islamic Republic of Iran 84 I.L.R.*, 484; L. C. Caflisch, "The Protection of Corporate Investments Abroad in the Light of the Barcelona Traction Case", (1971) 31 *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* 162, 180.

[102] Ibid., p. 202 (Judge Jessup).

[103] Ibid., p. 207 (Judge Jessup).

[104] Brownlie, supra note 97, at p. 487.

not disturbed the authority of *Barcelona Traction*.] Even if these treaties are to be seen as evidence of State practice, it is doubtful whether a rule in favour of economic control enjoys the support of most States in today's world. While some developed States may endorse a rule in favour of shareholders' claims under the banner of economic control, there is no evidence that such a rule enjoys the support of developing nations. On the contrary, it has been argued that such a rule would increase the number of claims by developed nations on behalf of their nationals holding shares in companies doing business in developing States.[105] This is probably only conjecture, but it does suggest that a rule of this kind does not enjoy the acceptance of developing States.

37. If the Commission elects to formulate a rule in favour of economic control, it will act by way of progressive development rather than by way of codification. Whether this is warranted in the light of the difficulties surrounding such a rule is for the Commission to decide.

*Option 5: The State of incorporation and the state of economic control*

38. International law recognizes the possibility of diplomatic protection by either or both States of nationality in the case of an injury to a dual national.[106] Similarly international law recognizes that an officer of an international organization may be protected by either his or her State of nationality or the organization or by both.[107] Why then, the question may be asked, should dual protection of a company and the State of economic control not be recognized so as to allow either the State of incorporation of the company or the State of economic control to exercise diplomatic protection? Is it not enough simply to state, as does the International Court in *Barcelona Traction*,[108] that there is no analogy between the above cases of dual protection and the case of company and its controlling shareholders?

39. The possibility of dual protection of this kind receives support from the separate opinion of Judges Tanaka[109] and Jessup[110] in *Barcelona Traction*. According to Judge Tanaka:

> "It is true that there is no rule of international law which allows two kinds of diplomatic protection to a company and its shareholders respectively, but there is no rule of international law either which prohibits double protection. It seems that a lacuna exists here: it must be filled by an interpretation which emanates from the spirit of the institution of diplomatic protection itself."[111]

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[105] See Abi-Saab, supra note 81.

[106] See article 5 of the draft articles on diplomatic protection adopted by the Commission in 2002. *Official Records of the General Assembly, Fifty-seventh session, Supplement No. 10* (A/57/10), para. 281, pp. 181-183.

[107] *Reparation for Injuries Suffered in the Service of the United Nations, 1949 I.C.J. Reports*, 174, 186. After this decision recognizing that two claims might be presented on behalf of an injured official, the General Assembly authorized the Secretary-General of the United Nations to negotiate agreements to reconcile action by the United Nations with the rights of the State of which the injured person was a national. See General Assembly resolution 365 (IV), para 2. See further the separate opinion of Judge Jessup, *1970 I.C.J. Reports*, p. 199.

[108] Ibid., paras. 53 and 98.

[109] Ibid., pp. 130-133.

[110] Ibid., pp. 199-202.

[111] Ibid., p. 131. See also the separate opinion of Judge Wellington Koo in *Barcelona Traction (Preliminary Objections), 1964 I.C.J. Reports*, pp. 59-61.

There is no danger in such a case of double protection that the defendant State will be compelled to pay reparation twice over since "if a claim of one State is realized, the claim of the other State will be extinguished to this extent by losing its object."[112]

40. The Commission should give serious attention to the possibility of dual protection. If, however, it finds the criticisms levelled at the test of economic control in paragraphs 32 and 33 to be persuasive, it would make no sense to approve such a test in the context of dual protection.

*Option 6: The State of incorporation, failing which the state of economic control*

41. Related to option 5 is the possibility of a secondary right of diplomatic protection vested in the State of economic control which arises if, and only if, the State of incorporation waives its right to diplomatic protection or fails to exercise this right over a long period of time, as did Canada in *Barcelona Traction*. Such a possibility was contemplated by Judge Fitzmaurice in his separate opinion in *Barcelona Traction* when he stated that where the State of incorporation fails to exercise diplomatic protection "for reasons of its own *that have nothing to do with the interests of the company* ... even though there may be a good, or apparently good case in law for doing so, and the interests of the company require it", the State of nationality of the shareholders ought to be able to act — in the same way that "on the domestic plane an analogous failure or refusal on the part of the management of the company would normally enable the shareholders to act," either against the management or a third party.[113]

42. Support for the notion of a secondary right to protection is to be found in the procedures of the United Nations Compensation Commission which provide that:

> "Each Government may submit claims on behalf of corporations or other entities that, on the date on which the claim arose, were incorporated or organized under its law. Claims may be submitted on behalf of a corporation or other entity by only one Government. A corporation or other entity would be required to request the State of its incorporation or organization to submit its claim to the Commission. In the case of a corporation or other private legal entity whose State of incorporation or organization fails to submit, within the deadline established in paragraph 29, such claims falling within the applicable criteria, the corporation or other private legal entity may itself make a claim to the Commission within three months thereafter."[114]

43. This option is open to the same objection as option 5. If the test of economic control is unsatisfactory, it should not be contemplated either as a secondary or as a primary test of nationality. There is, however, a more compelling objection. As was pointed out by the International Court in *Barcelona Traction*, a secondary right only comes into existence when the original right ceases to exist and it will be difficult in practice to determine when such a right is extinguished, as a State may simply decline to exercise its discretion to protect a corporation without any intention of abandoning its claim, as appeared to be the position of Canada in *Barcelona*

[112] Judge Tanaka, *1970 I.C.J. Reports*, pp. 130-131. See also Judge Jessup, ibid., p. 200.

[113] Ibid., p. 76. See also the separate opinion of Judge Wellington Koo in *Barcelona Traction (Preliminary Objections), 1964 I.C.J. Reports*, p. 59.

[114] Decision 7 of the Governing Council, para. 26, S/AC.26/1991/7/Rev.1 (17/3/1992).

*Traction*.[115] While this objection might be overcome by setting a prescribed time limit for the exercise of the primary right, this would not overcome another obstacle raised by the International Court, that is, the difficulty that would arise if the State of incorporation settled a claim in a manner unsatisfactory to the company's shareholders. Could the State of economic control then lodge a secondary claim to give effect to the demands of the shareholders?

*Option 7: The States of nationality of all shareholders*

44. The suggestion that the States of nationality of all shareholders in a company be permitted to exercise diplomatic protection was dismissed by the Court in *Barcelona Traction* in the following terms:

> "The Court considers that the adoption of the theory of diplomatic protection of shareholders as such, by opening the door to competing diplomatic claims, could create an atmosphere of confusion and insecurity in economic relations. The danger would be all the greater in as much as the shares of companies whose activity is international are widely scattered and frequently change hands."[116]

45. That another position, one in favour of multiple protection, is tenable was emphasized by Judge Tanaka,[117] in arguing that in principle every shareholder should have the right of diplomatic protection. He did not anticipate that this would result in chaos, first because of the discretionary nature of diplomatic protection, and secondly because it was likely that in practice there would be joint action on the part of States concerned. A similar stance was adopted by Judge Fitzmaurice, who argued that a multiplicity of claims was a problem only for the *"quantum* of reparation recoverable by the various Governments." He continued:

> "Once the principle of claims on behalf of shareholders had been admitted for such circumstances, it would not be difficult to work out ways of avoiding a multiplicity of *proceedings*, which is what would really matter."[118]

46. Judges Tanaka and Fitzmaurice are correct that a multiplicity of proceedings might be avoided by negotiations among the concurrent shareholders followed by joint action. Nevertheless the likelihood of confusion and chaos remains a possibility. In 1949, Mervyn Jones warned of such dangers when he wrote that if the State of nationality of each shareholder were permitted to exercise diplomatic protection:

> "the results would be just as chaotic on the international plane as they would be under municipal law if any group of shareholders were allowed to sue in any case where the company has sustained damage ...

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[115] *1970 I.C.J. Reports*, paras. 96-97.

[116] *1970 I.C.J. Reports*, p. 49, para. 96. See also the separate opinion of Judge Padilla Nervo, p. 264.

[117] Ibid., pp. 128-131.

[118] Ibid., p. 77, footnote 21. This view is endorsed by Rosalyn Higgins, "Case concerning the Barcelona Traction, Light and Power Company Ltd", (1971) 11 *Virginia Journal of International Law* 327, 339. See also "Panel: — Nationality of Claims — Individuals, Corporations, Stockholders", (1969) 63 *American Society of International Law, Proceedings*, 30.

"[S]hareholders are not infrequently corporations themselves, and the process of identifying individual shareholders might be prolonged ad infinitum; such a process is in any case difficult in practice."[119]

The *Barcelona Traction* case itself provides abundant proof of the difficulty in identifying shareholders in the case of a multinational corporation.[120]

## B. Proposed articles on diplomatic protection of corporations and shareholders

47. *Barcelona Traction* may be faulted on several grounds. Nevertheless, it enjoys widespread acceptance on the part of States.[121] In the light of this acceptance, and the objections to other tests for determining the nationality of corporations,[122] the wisest course seems to be to formulate articles that give effect to the principles expounded in *Barcelona Traction*. The following articles endorse both the primary rule in the *Barcelona Traction* — namely that the State of incorporation of a company enjoys the right to exercise diplomatic protection on behalf of the company — and the exceptions to this rule, recognized, to a greater or lesser extent, by the Court.

### Part Three
### Legal persons

**Article 17**

**1. A State is entitled to exercise diplomatic protection in respect of an injury to a corporation which has the nationality of that State.**

**2. For the purposes of diplomatic protection, the State of nationality of a corporation is the State in which the corporation is incorporated [and in whose territory it has its registered office].**

**Article 18**

**The State of nationality of the shareholders in a corporation shall not be entitled to exercise diplomatic protection on behalf of such shareholders in the case of an injury to the corporation unless:**

**(a) The corporation has ceased to exist in the place of its incorporation; or**

**(b) The corporation has the nationality of the State responsible for causing injury to the corporation.**

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[119] "Claims on behalf of Nationals who are Shareholders in Foreign Companies", (1949) 26 *British Year Book of International Law*, 225, 234-235.

[120] See the comment of Judge Jessup, *1970 I.C.J. Reports*, pp. 219-220.

[121] See para. 26 above.

[122] See paras. 29-36 above.

**Article 19**

**Articles 17 and 18 are without prejudice to the right of the State of nationality of shareholders in a corporation to protect such shareholders when they have been directly injured by the internationally wrongful act of another State.**

**Article 20**

**A State is entitled to exercise diplomatic protection in respect of a corporation which was incorporated under its laws both at the time of the injury and at the date of the official presentation of the claim [; provided that, where the corporation ceases to exist as a result of the injury, the State of incorporation of the defunct company may continue to present a claim in respect of the corporation].**

## 1. Article 17

*Article 17, paragraph 1*

**A State is entitled to exercise diplomatic protection in respect of an injury to a corporation which has the nationality of that State.**

48. Article 17 (1) reaffirms the principle expounded in *Barcelona Traction*.[123] It mirrors article 3 (1) of the draft articles adopted by the Commission on first reading, which declares that "the State entitled to exercise diplomatic protection is the State of nationality."

49. Article 2 of the draft articles affirms the "right" of the State to exercise diplomatic protection. It is under no obligation to do so — a principle which applies with equal force to natural and legal persons. This was emphasized by the International Court in *Barcelona Traction* when it declared:

> "... within the limits prescribed by international law, a State may exercise diplomatic protection by whatever means and to whatever extent it thinks fit, for it is its own right that the State is asserting. Should the natural or legal persons on whose behalf it is acting consider that their rights are not adequately protected, they have no remedy in international law. All they can do is to resort to municipal law, if means are available, with a view to furthering their cause or obtaining redress. The municipal legislator may lay upon the State an obligation to protect its citizens abroad, and may also confer upon the national a right to demand the performance of that obligation, and clothe the right with corresponding sanctions. However, all these questions remain within the province of municipal law and do not affect the position internationally.
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> "The State must be viewed as the sole judge to decide whether its protection will be granted, to what extent it is granted, and when it will cease. It retains in this respect a discretionary power the exercise of which may be determined by considerations of a political or other nature, unrelated to the particular case. Since the claim of the State is not identical with that of the

[123] *1970 I.C.J. Reports*, pp. 42 (para. 70) and 46 (para. 88).

individual or corporate person whose cause is espoused, the State enjoys complete freedom of action."[124]

50. It is for the State of incorporation of a company to decide whether it will exercise diplomatic protection on behalf of the company. Where there is no real link between a State and a company holding its nationality, for example, where the company has been incorporated in that State for tax benefits, it is unlikely that the national State will exercise diplomatic protection on its behalf. In this respect the relationship between State and corporation is similar to that between a State and a ship flying its flag of convenience. It is more likely that a State will exercise diplomatic protection where there is some real link between State and company, as where the majority of the shareholders of the company are nationals of that State. Indeed a State may declare in advance that it will only exercise diplomatic protection in circumstances of this kind.[125] An additional requirement of this kind serves to guide a State in the exercise of its discretion and is not the concern of international law. International law, as reflected in *Barcelona Traction*, entitles (but does not require) a State to exercise diplomatic protection on behalf of a company incorporated under its laws.

51. The discretionary right to exercise diplomatic protection, completely uncontrolled by rules of international law, provides little security to shareholders who invest in the company in the expectation that their investment will be protected by the State of nationality when the company does business abroad. For this reason investors will prefer the security of bilateral investment treaties and encourage the State of nationality of the corporation to enter into such agreements with countries that offer both high profits and high risks. This entails an acceptance of the pessimistic assessment of the situation by Julienne Kokott: "in the context of foreign investment, the traditional law of diplomatic protection has been to a large extent replaced by a number of treaty-based dispute settlement procedures."[126] Some support for this view is to be found in the judgment of the International Court when it stated:

> "Thus, in the present state of the law, the protection of shareholders requires that recourse be had to treaty stipulation or special agreements directly concluded between the private investor and the State in which the investment is placed. States ever more frequently provide for such protection, in both bilateral and multilateral relations, either by means of special instruments or within the framework of wider economic arrangements. Indeed, whether in the form of multilateral or bilateral treaties between States, or in that of agreements between States and companies, there has since the Second World War been considerable development in the protection of foreign investments. The instruments in question contain provisions as to jurisdiction and procedure

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[124] Ibid., p. 44, paras. 78-79.

[125] The British Government has issued rules relating to international claims which indicate that Her Majesty's Government may take up the claim of a company incorporated in the United Kingdom (Rule IV). However, the comment on this rule provides: "In determining whether to exercise its right of protection, Her Majesty's Government may consider whether the company has in fact a real and substantial connection with the United Kingdom"(1988) 37 *I.C.L.Q.* 1006, 1007. In its intervention in the Sixth Committee debate on diplomatic protection in 2002 the United States likewise declared that "the United States does take the nationality of shareholders into consideration in deciding whether to exercise its discretion to extend diplomatic protection to a corporation", A/C.6/57/SR.23, para. 52.

[126] Supra, note 48.

in case of disputes concerning the treatment of investing companies by the States in which they invest capital. Sometimes companies are themselves vested with a direct right to defend their interests against the States through prescribed procedures."[127]

*Article 17, paragraph 2*

**For the purposes of diplomatic protection, the State of nationality of a corporation is the State in which the corporation is incorporated [and in whose territory it has its registered office].**

52. This provision echoes the dictum by the International Court in *Barcelona Traction* that:

"The traditional rule attributes the right of diplomatic protection of a corporate entity to the State under the laws of which it is incorporated and in whose territory it has its registered office."[128]

53. The dictum cited in the preceding paragraph sets two conditions for the acquisition of nationality by a corporation for the purposes of diplomatic protection: incorporation and the presence of the registered office of the company in the State of incorporation. In practice the laws of most States require a company incorporated under its laws to maintain a registered office in its territory.[129] Thus the additional requirement of registered office seems superfluous. Nevertheless the International Court made it clear that both conditions should be met when it stated: "These two criteria have been confirmed by long practice and by numerous international instruments."[130] Possibly the International Court sought to recognize in the requirement of registered office the need for some tangible connection, however small, between State and company. This is confirmed by the emphasis it placed on the fact that *Barcelona Traction's* registered office was in Canada and that this created, together with other factors, the "close and permanent connection" between Canada and *Barcelona Traction*.[131] In practice it would seem that the Court's insistence on the requirement of a registered office is misplaced. The presence of a registered office in the State of incorporation is a consequence of incorporation and not independent evidence of a connection with that State. Indeed, where a company registers in a State solely to obtain tax advantages, which not infrequently occurs, the registered office will be little more than a mailing address. There is no harm in retaining this requirement *ex abundanti cautela* and to follow the language of *Barcelona Traction* faithfully. On the other hand, the Commission may prefer to omit the reference to the need for a registered office in addition to incorporation.

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[127] *1970 I.C.J. Reports*, p. 47, para. 90.

[128] Ibid., p. 42, para. 70.

[129] The Special Rapporteur cannot claim to have carried out a thorough comparative study on this subject. A brief survey of the subject shows, however, that this is the position in South Africa (P. Meskin (ed.), *Henochsberg on the Companies Act*, 4th ed. (1985), p. 254), Spain (*Spanish Corporation Law and Limited Liability Company Law*, trans. by Santiago C. Minguela (1996)), Ireland (M. Forde *Company Law*, 3rd ed. (1999) p. 59) and the United Kingdom (*Halsbury's Laws of England* (4th ed.). p. 125).

[130] *1970 I.C.J. Reports*, p. 42, para. 70.

[131] Ibid., pp. 33-42, para. 71.

54. The International Court in *Barcelona Traction* made it clear that there are no rules of international law on the incorporation of companies.[132] Consequently it was necessary to have recourse to the municipal law to ascertain whether the conditions for incorporation had been met. The Court stated:

> "All it means is that international law has had to recognize the corporate entity as an institution created by States in a domain essentially within their domestic jurisdiction. This in turn requires that, whenever legal issues arise concerning the rights of States with regard to the treatment of companies and shareholders, as to which rights international law has not established its own rules, it has to refer to the relevant rules of municipal law."[133]

55. In *Barcelona Traction* Judge Morelli suggested that the law of the defendant State should determine this matter.[134] This view cannot be accepted for the following reasons given by Christopher Stalker:

> "... it is fundamentally difficult to assert that a State is completely free to decide, as property is brought into its territory, in whom that property vests, irrespective of the municipal laws of any other State. Logically, if this is the case, not only would it be possible (to use the example of the *Barcelona Traction* case) for Spain to deny recognition to a company validly incorporated under the laws of Canada by nationals of Belgium (and recognize the Belgian shareholders as being the actual owners), but it could, for instance, 'recognize' property brought into its territory by a group of Belgian nationals as belonging to a Canadian company, even though under Canadian law no such company exists. If this were the case, every State could avoid possible diplomatic claims in respect of assets brought to its territory by foreigners by 'recognizing' them as the property of companies of third States having no interest in protecting them. By 'recognizing' a non-existent Canadian company, Spain would in effect itself be creating the company and conferring Canadian nationality on it. This runs counter to the well-established rule that one State cannot confer the nationality of another."[135]

Therefore there seems little doubt that it is to the law of the incorporating State that a court should turn to ascertain that the company has been properly incorporated.

56. The word "incorporated" is preferred to that of "registration". In practice the two terms are virtually synonymous. In order to acquire a separate corporate existence a company must submit its founding instruments to and be registered with the relevant national authorities. Once it is registered in this way it is incorporated and may obtain a certificate of incorporation. To draw an analogy with a natural person, the process of registration is the gestation of a company; its incorporation, following the completion of this process, is its birth; and the issue of a certificate of

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[132] Cf. the suggestion of Christopher Stalker that rules of international law might recognize as a juridical person for the purposes of diplomatic protection "an entity that does not have a juridical personality under the municipal law of any State on the basis of a general principle of law that a collectivity which in reality exists as an entity distinct from its constitutive members should be recognized as having a separate existence in law": "Diplomatic Protection of Private Business Companies: Determining Corporate Personality for International Law Purposes", (1990) 61 *British Year Book of International Law* 155, 169.

[133] *1970 I.C.J. Reports*, p. 33, para. 38; see also p. 37, para. 50.

[134] Ibid., pp. 235-236. See also L. Caflisch, *La protection des sociétés commerciales et des intérêts indirects en droit international public* (1969), p. 19.

[135] Supra, note 132, at 166-167.

incorporation is its birth certificate.[136] For this reason the term incorporation is preferred.

### 2. Article 18

**The State of nationality of the shareholders in a corporation shall not be entitled to exercise diplomatic protection on behalf of such shareholders in the case of an injury to the corporation unless:**

**(a) The corporation has ceased to exist in the place of its incorporation: or**

**(b) The corporation has the nationality of the State responsible for causing injury to the corporation.**

57. The International Court in *Barcelona Traction* recognizes that there are special circumstances that "on the international plane" may "justify the lifting of the [corporate] veil in the interest of the shareholders."[137] It does, however, limit such intervention to two cases: (a) where the company has ceased to exist and (b) where the company's national State lacks capacity to take action on its behalf.[138]

*Article 18, subparagraph (a)*

**The State of nationality of the shareholders may intervene when "the corporation has ceased to exist in the place of its corporation".**

58. This provision raises two issues that require careful scrutiny: first, the meaning of the term "ceased to exist" and whether it is the appropriate test to be employed; and secondly, whether the death of the company is to be judged by the law of the incorporating State or the law of the State in which the company has been injured.

59. Before *Barcelona Traction* it was accepted that the State of nationality of the shareholders might intervene when the company was no longer able to act on their behalf. Although there was support for the view that the test to be adopted was whether the company had ceased to exist,[139] the weight of authority seemed to

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[136] Section 64 of the South African Companies Act No. 61 of 1973 makes this process clear: "(1) Upon the registration of the memorandum and articles of a company the Registrar shall endorse thereon a certificate under his hand and seal that the company is incorporated. (2) A certificate of incorporation given by the Registrar in respect of any company shall upon its mere production, in the absence of proof of fraud, be conclusive evidence that all the requirements of this Act in respect of registration and of matters precedent and incidental thereto, have been complied with, and that the company is a company duly incorporated under this Act." See also *Gower's Principles of Modern Company Law*, ed. Paul L. Davies, 6th ed. (1997), at p. 111: "If the Registrar is satisfied that the requirements for registration are met and that the purpose for which the incorporators are associated is lawful, he issues a certificate of incorporation signed by him or authenticated under his official seal. This states that the company is incorporated and, in the case of a limited company that it is limited; it is, in effect, the company's certificate of birth as a body corporate on the date mentioned in the certificate."

[137] *1970 I.C.J. Reports*, p. 39, para. 58.

[138] Ibid., p. 40, para. 64.

[139] See the reply of the United Kingdom to the United States in the *Romano-Americano Company* dispute: "... It is not until a company has ceased to have an active existence or has gone into liquidation that the interests of its shareholders ceases to be merely the right to share in the company's profits and becomes a right to share in its actual surplus assets" (Hackworth, *Digest of International Law*, vol. V (1943), p. 843). The Mexican Government adopted a similar

favour a less stringent test, one that permitted intervention on behalf of shareholders when the company was "practically defunct". This latter test, first formulated in 1899, in the *Delagoa Bay Railway Co Case*,[140] was followed in State practice[141] and enjoyed the support of writers.[142]

60. The Court in *Barcelona Traction* set a higher threshold for determining the demise of a company. The "paralysis" or "precarious financial situation" of a company was dismissed as inadequate.[143] The test of "practically defunct" was likewise rejected as one "which lacks all legal precision".[144] Only the "company's status in law" was considered relevant. The Court stated:

> "Only in the event of the legal demise of the company are the shareholders deprived of the possibility of a remedy available through the company; it is only if they became deprived of all such possibility that an independent right of action for them and their Government could arise."[145]

This approach was endorsed by Judge Nervo, who in his separate opinion declared:

> "It is only when a company has been dissolved and consequently ceases to exist as a separate legal entity that the shareholders take its place and are entitled to receive the balance of its property, after the corporate debt has been deducted. Thus it is only the 'legal death' of the corporate person that may give rise to new rights appertaining to the shareholders as successors to the company."[146]

Other judges were less convinced about the correctness of this test: Judges Jessup[147]and Fitzmaurice[148] and Judge ad hoc Riphagen[149] inclined towards the test of "practically defunct".

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position in the *Mexican Eagle* dispute: see Jones, supra note 119, at 241. Eduardo Jiménez de Aréchaga, writing in 1968, on the eve of *Barcelona Traction*, required the loss of legal personality as a precondition for intervention by shareholders: "International Responsibility", in *Manual of Public International Law*, ed. Max Sørensen (1968), p. 531 at pp. 579-580.

[140] In 1887, the Portuguese Government cancelled the concession granted to a company incorporated under the laws of Portugal, but owned by British and American shareholders, to build a railway line from Lourenço Marques (now Maputo) to the Transvaal border, and seized its assets. Both Britain and the United States protested against this action and claimed that they were entitled to intervene on behalf of their shareholders as the Portuguese company was "practically defunct". This principle was later conceded by Portugal and an arbitration tribunal was established to decide on the question of compensation only: *Delagoa Bay Railway Co Case*, Moore, *Digest of International Law* (1906), vol. VI, p. 648. For a full examination of this case, see Mervyn Jones, supra note 119, 229-231. This approach was approved in the *El Triunfo* claim: Moore, *Digest of International Law* (1906), vol. VI, p. 649.

[141] See *Baasch & Romer* claim, 10 *U.N.R.I.A.A.* 723 (1903) (discussed in Jones, supra note 119 at 244-246); F. A. Mann, "The Protection of Shareholder's Interests in the Light of the Barcelona Traction Case", (1973) 67 *A.J.I.L.* 259, 267-268 (citing the argument of Professor Virally for Belgium in *Barcelona Traction*).

[142] I. Brownlie, *Principles of Public International Law* (1966), p. 401.

[143] *1970 I.C.J. Reports*, pp. 40-41, paras. 65 and 66.

[144] Ibid., p. 41, para. 66.

[145] Ibid.

[146] Ibid., p. 256; see also the separate opinion of Judge Ammoun, pp. 319-320.

[147] Ibid., p. 193 citing Brownlie, *Principles of Public International Law* (1966), p. 401, in favour of "practically defunct" as the correct test.

[148] Ibid., pp. 74-75.

[149] Ibid., p. 345.

61. Much of the criticism directed at the Court's adoption of the "ceased to exist" test is that it was not properly applied by the Court *to the facts* in *Barcelona Traction*.[150] This does not detract from the value of the test itself: it is more precise than that of the "practically defunct" test, but inevitably opinion will differ as to whether it has been correctly applied in a particular case.

62. The "ceased to exist" test was endorsed in 1995 by the European Court of Human Rights in the *Agrotexim* case when it refused to find that a company was unable to act qua company because, although in a process of liquidation, it "had not ceased to act as a legal person".[151] It also obtains support from the United Kingdom's 1985 Rules Applying to International Claims, which contemplate intervention only where the company is "defunct".[152]

63. Unfortunately the Court in *Barcelona Traction* did not expressly state that the company must have ceased to exist in *the place of incorporation* as a precondition to shareholders' intervention.[153] Nevertheless it seems clear in the context of the proceedings before it that the Court intended that the company should have ceased to exist in the State of incorporation and not in the State in which the company was injured. The Court was prepared to accept that the company was destroyed in Spain[154] — a view shared by Judges Fitzmaurice[155] and Jessup[156] — but emphasized that this did not affect its continued existence in Canada, the State of incorporation:

> "In the present case, *Barcelona Traction* is in receivership in the country of incorporation. Far from implying the demise of the entity or of its rights, this much rather denotes that those rights are preserved for so long as no liquidation has ensued. Though in receivership, the company continues to exist."[157]

64. A company is "born" in the State of incorporation when it is registered and incorporated. Conversely, it "dies" when it is wound up in its State of incorporation, the State which gave it its existence. It therefore seems logical that the question whether a company has ceased to exist, and is no longer able to function as a corporate entity, must be determined by the law of the State in which it is incorporated.

*Article 18, subparagraph (b)*

**The State of nationality of the shareholders may intervene when "the corporation has the nationality of the State responsible for causing injury to the corporation".**

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[150] See the criticism of Mann, supra note 141 at 268.

[151] Series A, No. 330-A, p. 25, para. 68.

[152] Rule V, reproduced in (1988) 37 *I.C.L.Q.* 1007.

[153] This led F. A. Mann to comment: "[T]he Court does not indicate the legal system upon which its conclusions are based. Is it Canadian or Spanish law? Or is it international law, particularly that branch of it which relates to diplomatic protection" (supra note 141 at 265).

[154] *1970 I.C.J. Reports*, p. 40, para. 65.

[155] Ibid., p. 75.

[156] Ibid., p. 194.

[157] Ibid., p. 41, para. 67.

65. The most important exception to the rule that the State of nationality of a corporation may alone exercise diplomatic protection on behalf of the company is that which allows the State of nationality of the shareholders to intervene where "the corporation has the nationality of the State responsible for causing injury to the corporation" (article 18 (b)). A capital-importing State will not infrequently require a foreign consortium wishing to do business in its territory to do so through the instrument of a company incorporated under its law.[158] If such a State then confiscates the assets of the company or injures it in some other way, the only relief for the company on the international plane lies in action taken by the State of nationality of the shareholders. According to Mervyn Jones, in his seminal article on this subject, "Claims on Behalf of Nationals who are Shareholders in Foreign Companies", written in 1949:

> "In such cases intervention on behalf of the corporation is not possible under the normal rule of international law, as claims cannot be brought by foreign States on behalf of a national against its own Government. If the normal rule is applied, foreign shareholders are at the mercy of the State in question; they may suffer serious loss, and yet be without redress. This is an extension in the international field of the situation which may arise in municipal law when those who should be defending the interest of the corporation fraudulently or wrongfully fail to do so (e.g. *Foss* v. *Harbottle*)."[159]

66. The existence of such a rule is not free from controversy. Moreover, there are suggestions that it is only to be recognized either where the injured company was compelled to incorporate in the wrongdoing State or where the company is "practically defunct".

67. The Court in *Barcelona Traction* raised the possibility of such a rule but declined to give an answer on either its existence or its scope. The present report will examine the status of such an exception before *Barcelona Traction*, the judgment of the Court in this case, the differing separate opinions attached to that judgment, subsequent developments and the present status of the exception.

*Pre*-Barcelona Traction*: practice, jurisprudence and doctrine*

68. There is evidence in support of such an exception before *Barcelona Traction* in State practice, arbitral awards and doctrine, all of which are comprehensively examined by Lucius Caflisch in *La protection des sociétés commerciales et des intérêts indirects en droit international public*.[160] State practice and arbitral decisions are, however, far from clear, as illustrated by the different assessments of the evidence by Jones[161] and Jiménez de Aréchaga.[162]

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[158] See W. E. Beckett, "Diplomatic Claims in Respect of Injuries to Companies", (1932) 17 *Transactions of the Grotius Society* 175, 188-189.

[159] (1949) 26 *B.Y.I.L.* 225, 236.

[160] The Hague: Martinus Nijhoff, 1969.

[161] Supra note 159.

[162] "International Responsibility", in *Manual of Public International Law*, ed. Max Sørensen (1968), p. 531 at pp. 580-581.

69. Jones points to several disputes in which the United Kingdom and/or the United States asserted the existence of such an exception, notably the cases concerning the *Delagoa Bay Railway Company*,[163] the *Tlahualilo Company*,[164] the *Romano-Americano*[165] and the *Mexican Eagle (El Águila)*.[166] None of these cases, however, provides conclusive evidence in support of such an exception. In the *Delagoa Bay Railway* case the United Kingdom and the United States both strongly asserted the existence of such a principle when they intervened to protect their nationals who were shareholders in a Portuguese company injured by Portugal itself, but the arbitral tribunal that considered the dispute was limited to fixing the compensation to be awarded. At best it can be said that Portugal acknowledged such a principle when it accepted the validity of the United Kingdom/United States claim.[167] In both *Tlahualilo* and *Mexican Eagle* the Government of Mexico rejected the existence of the exception and "the final solution was found by common agreement through corporate remedies."[168] Furthermore, in the *Romano-Americano* dispute between the United States and the United Kingdom, the latter denied the existence of such an exception.[169] It is difficult not to agree with Jiménez de Aréchaga that "[n]o certain argument may be made, therefore, on the basis of such limited and contradictory State practice."[170]

70. Judicial decisions are likewise inconclusive. The *Alsop*,[171] *Cerruti*,[172] *Orinoco Steamship*[173] and *Ziat Ben Kiran*[174] claims, sometimes cited in support of an exception in favour of shareholder claims, do not really provide such support.[175] The *Baasch & Romer*[176] and *Kunhardt*[177] claims are at best unclear, but possibly against the proposed exception, as in these and other claims,[178] the Venezuelan Mixed Commissions rejected claims on behalf of the shareholders of corporations of

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[163] Supra, note 140.

[164] Jones supra, note 159, at 237; Caflisch, supra note 160 at pp. 194-197.

[165] Hackworth, *Digest of International Law*, vol. V, p. 841.

[166] M. Whiteman, *Digest of International Law*, vol. VIII, pp. 1272-1274; Jones, supra note 159, at 241.

[167] Jones, supra note 159, at 230-231.

[168] De Aréchaga, supra note 162, at p. 580.

[169] Supra, note 165, at p. 843.

[170] Supra, note 162, at p. 580. Cf. the conclusion of Caflisch:
"Nous constatons en premier lieu que le principe même de la protection des participations étrangères dans des sociétés relevant de l'Etat défendeur, admis par la jurisprudence internationale, est confirmé par la pratique des Etats. D'une part, cette protection n'a été que rarement refusée par l'Etat national de la personne titulaire de l'intérêt indirect; d'autre part, nous ne connaissons pas de cas où un État défendeur qui s'est opposé à admettre la protection des intérêts indirects ait finalement eu gain de cause", supra note 160, p. 203.

[171] U.S. v Chile, 11 *U.N.R.I.A.A.* 349 (1911); (1911) 5 *A.J.I.L.* 1079.

[172] Colombia v. Italy, (1899) 6 *Revue générale de droit international public* 593.

[173] U.S. v. Venezuela, 9 *U.N.R.I.A.A.* 180 (1903).

[174] U.K. v. Spain, 2 *U.N.R.I.A.A.* 729 (1924).

[175] Jones, supra note 159, 243-244; de Aréchaga, supra note 162, p. 581; Caflisch, supra note 160, pp. 173, 183-187.

[176] Netherlands v. Venezuela, 10 *U.N.R.I.A.A.* 723 (1903).

[177] U.S. v. Venezuela, 9 *U.N.R.I.A.A.* 171 (1903).

[178] *Henriquez Case*, Netherlands v. Venezuela, 10 *U.N.R.I.A.A.* 713 (1903), *Brewer, Moller & Co.*, Germany v. Venezuela, 10 *U.N.R.I.A.A.* 433 (1903).

Venezuelan nationality.[179] The *El Triunfo* claim[180] does, however, provide some support for the exception as in that case a majority of the arbitrators concurred in the award of damages in favour of the United States against El Salvador, which was responsible for an injury to a company incorporated in El Salvador with American shareholders. There the arbitrators stated:

> "We have not discussed the question of the right of the United States under international law to make reclamation for these shareholders in the El Triunfo Company, a domestic corporation of Salvador, for the reason that the question of such right is fully settled by the conclusions reached in the frequently cited and well-understood Delagoa Bay Railway arbitration."[181]

71. Respect for the *Delagoa Bay Railway* principle was also expressed in the *Deutsche Amerikanische Petroleum Gesellschaft Oil Tankers*, in which the tribunal stated that in the *Delagoa Bay Railway* and *El Triunfo* cases the shareholders were exercising "not their own rights but the rights which the company, wrongfully dissolved or despoiled, was unable thenceforth to enforce; and ... they were therefore seeking to enforce not direct and personal rights, but indirect and substituted rights."[182]

72. In summary, it may be said that while the authorities do not clearly proclaim the right of a State to take up the case of its nationals,[183] as shareholders in a corporation, for acts affecting the company, against the State of nationality of a company, the language of some of these awards lends some support, albeit tentative, in favour of such a right.[184]

73. Significantly, the strongest support for intervention on the part of the State of nationality of the shareholders comes from the three claims in which the injured corporation had been *compelled* to incorporate in the wrongdoing State: *Delagoa Bay Railway*, *Mexican Eagle* and *El Triunfo*. While there is no suggestion in the language of these claims that intervention is to be limited to such instances, there is no doubt that it is in such cases that intervention is most needed. As the Government of the United Kingdom replied to the Mexican argument in *Mexican Eagle* that a State might not intervene on behalf of its shareholders in a Mexican company:

> "If the doctrine were admitted that a Government can first make the operation of foreign interests in its territories depend upon their incorporation under local law, and then plead such incorporation as the justification for rejecting foreign diplomatic intervention, it is clear that the means would never be wanting whereby foreign Governments could be prevented from exercising their undoubted right under international law to protect the commercial interests of their nationals abroad."[185]

74. Writers in the pre-*Barcelona Traction* period were divided on the question whether international law recognized a right of diplomatic intervention on behalf of

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[179] De Aréchaga, supra note 162, p. 581.

[180] 15 *U.N.R.I.A.A.* 467 (1902); Moore Digest of International Law, vol. VI, p. 649; United States Foreign Relations (1902), pp. 838-852.

[181] 15 *U.N.R.I.A.A.* 479; *United States Foreign Relations* (1902), p. 873.

[182] 2 *U.N.R.I.A.A.* 779 (1926) at 790.

[183] De Aréchaga, supra note 162, p. 580.

[184] Jones, supra note 159, at 251, 257; Caflisch, supra note 160, p. 192.

[185] M. Whiteman, *Digest of International Law*, vol. VIII, pp. 1273-1274.

shareholders in a company incorporated in the wrongdoing State. Beckett,[186] Charles de Visscher,[187] Jones,[188] Paul de Visscher,[189] Petrén,[190] Kiss[191] and Caflisch[192] favoured such a rule, while de Aréchaga[193] and O'Connell[194] opposed it. Judge Wellington Koo, in his separate opinion in *Barcelona Traction (Preliminary Objections)* in 1964, declared that:

> "... State practice, treaty regulation and international arbitral decisions have come to recognize the right of a State to intervene on behalf of its nationals, shareholders of a company which has been injured by the State of its own nationality, that is to say, a State where it has been incorporated according to its laws and therefore is regarded as having assumed its nationality."[195]

Barcelona Traction

75. In *Barcelona Traction*, Spain, the respondent State, was not the State of nationality of the injured company. Consequently, the exception under discussion was not before the Court. Nevertheless the Court did make passing reference to this exception:

> "It is quite true that it has been maintained that, for reasons of equity, a State should be able, in certain cases, to take up the protection of its nationals, shareholders in a company which has been the victim of a violation of international law. Thus a theory has been developed to the effect that the State of the shareholders has a right of diplomatic protection when the State whose responsibility is invoked is the national State of the company. Whatever the validity of this theory may be, it is certainly not applicable to the present case, since Spain is not the national State of Barcelona Traction."[196]

76. That the Court was sympathetic to the notion of protection by the State of nationality of shareholders when equity and reason so required is clear from the passages of the Court's judgment which immediately follow the above pronouncement:

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[186] Supra note 158, at 188-194. Beckett deduces such a rule from general principles of law in the absence of a customary international law rule.

[187] "De la protection diplomatique des actionnaires d'une société contre l'Etat sous la législation duquel la société s'est constituée", (1934) 15 *Revue de droit international et de legislation comparée* (3rd Series) 624.

[188] Supra, note 159.

[189] "La protection diplomatique des personnes morales", (1960-I) 102 *Recueil des Cours* ... 395, 478-479.

[190] "La confiscation des biens étrangers et les reclamations internationales auxquelles elle peut donner lieu", (1963-II) 109 *Recueil des Cours* ... 492, 506, 510.

[191] "La protection diplomatique des actionnaires dans la jurisprudence et la pratique internationale", in *La personalité morale et ses limites* (Université de Paris, Institut de droit comparé, 1960), pp. 179-210.

[192] Supra note 160.

[193] Supra note 162.

[194] *International Law*, 2nd ed. (1970), pp. 1043-1047.

[195] *1964 I.C.J. Reports*, p. 58, para. 20.

[196] *1970 I.C.J. Reports*, p. 48, para. 92. Cf. the comment by F. A. Mann that Barcelona Traction might have had the "functional nationality" of Spain, in which case this exception might have been relevant; supra note 57, 271-272.

> "On the other hand, the Court considers that, in the field of diplomatic protection as in all other fields of international law, it is necessary that the law be applied reasonably. It has been suggested that if in a given case it is not possible to apply the general rule that the right of diplomatic protection of a company belongs to its national State, considerations of equity might call for the possibility of protection of the shareholders in question by their own national State. This hypothesis does not correspond to the circumstances of the present case.
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> "In view, however, of the discretionary nature of diplomatic protection, considerations of equity cannot require more than the possibility for some protector State to intervene, whether it be the national State of the company, by virtue of the general rule mentioned above, or, in a secondary capacity, the national State of the shareholders who claim protection."[197]

77. Judges Fitzmaurice,[198] Tanaka[199] and Jessup[200] expressed full support for the right of the State of nationality of the shareholders to intervene when the company was injured by the State of incorporation. Judge Fitzmaurice stated:

> "It seems that, actually, in only one category of situation is it more or less definitely admitted that intervention by the Government of foreign shareholders is allowable, namely where the company concerned has the nationality of the very State responsible for the acts or damage complained of, and these, or the resulting circumstances, are such as to render the company incapable de facto of protecting its interests and hence those of the shareholders."[201]

Judge Fitzmaurice conceded that this type of situation was most likely to arise where the company's nationality did not result "from voluntary incorporation" but was "imposed on it by the Government of the country or by a provision of its local law as a condition for operating there, or of receiving a concession."[202] Nevertheless, he was not prepared to limit the right of the State of nationality of shareholders to intervene to such circumstances as it was "the fact of local incorporation but with foreign shareholding" that mattered and not the motivation or process that brought it about.[203]

Judge Jessup stated that the rationale for this exception "seems to be based largely on equitable considerations and the result is so reasonable it has been accepted in State practice."[204] Like Judge Fitzmaurice, he accepted that "[t]he equities are particularly striking when the respondent State admits foreign investment only on condition that the investors form a corporation under its law",[205] but he did not limit the exception to such circumstances.

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[197] *1970 I.C.J. Reports*, p. 48, paras. 93-94.
[198] Ibid., pp. 72-75.
[199] Ibid., p. 134.
[200] Ibid., pp. 191-193.
[201] Ibid., p. 72, para. 14.
[202] Ibid., p. 73, para. 15.
[203] Ibid., para. 16.
[204] Ibid., pp. 191-192.
[205] Ibid., p. 192.

78. Judges Padilla Nervo,[206] Morelli[207] and Ammoun,[208] on the other hand, were vigorously opposed to such an exception. Judge Padilla Nervo declared that the Court's pronouncement on this subject "should not be interpreted as an admission that such 'theory' might be applicable in other cases where the State whose responsibility is invoked is the national State of the company."[209]

79. The statement of the Court on this subject was clearly obiter dictum,[210] as was its more famous obiter dictum in the same judgment on obligations *erga omnes*.[211] Nevertheless it may be argued that by referring to such an exception in the context of principles of equity and reason the Court wished to signal its support for such an exception, as it clearly did in the case of obligations *erga omnes*.[212]

*Post*-Barcelona Traction *Developments*

80. Developments relating to the proposed exception in the post-*Barcelona Traction* period have occurred mainly in the context of investment treaties. Nevertheless they do indicate support for the notion that the shareholders of a company may intervene against the State of incorporation of the company when it has been responsible for causing injury to the company.

81. In the *Case Concerning Elettronica Sicula S.p.A. (ELSI)*[213] a Chamber of the International Court of Justice allowed the United States to bring a claim against Italy in respect of damages suffered by an Italian company whose shares were wholly owned by two American companies. As shown above,[214] the Court avoided pronouncing on the compatibility of its finding with that of *Barcelona Traction* or on the proposed exception left open in *Barcelona Traction* despite the fact that Italy objected that the company whose rights were alleged to have been violated was incorporated in Italy and that the United States sought to protect the rights of shareholders in the company.[215] This silence might be explained on a number of grounds,[216] particularly the fact that the Chamber was not concerned with the evaluation of customary international law but with the interpretation of a bilateral Treaty of Friendship, Commerce and Navigation which provided for the protection of United States shareholders abroad. On the other hand, the proposed exception was clearly before the Chamber, as is shown by the exchange between Judges Oda and Schwebel in their separate opinions. Judge Oda stated, in respect of the attempt on the part of the United States to protect the interests of two American corporations, Raytheon and Machlett, in ELSI, an Italian company:

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206 Ibid., pp. 257-259.

207 Ibid., pp. 240-241.

208 Ibid., p. 318.

209 Ibid., p. 257.

210 See the comment of Lucius Caflisch in the American Society of International Law Round Table on "Toward More Adequate Protection of Private Claims: 'Aris Gloves', 'Barcelona Traction' and Beyond", (1971) 65 *Proceedings of the American Society of International Law* 333, 347-348. Caflisch did, however, make it clear that international law recognizes such an exception.

211 *1970 I.C.J. Reports*, p. 32, paras. 33-34.

212 Such an inference is drawn by Ignaz Seidl-Hohenveldern in Round Table, supra note 210 at 347; *Corporations in and under International Law* (1987), pp. 9-10.

213 *1989 I.C.J. Reports*, p. 15.

214 Supra, paras. 23-26.

215 *1989 I.C.J. Reports*, pp. 64, (para. 106), 79 (para. 132).

216 Supra, para. 25.

> "Raytheon and Machlett certainly could, in Italy, 'organize, control and manage' corporations in which they held 100 per cent of the shares — as in the case of ELSI — but this cannot be taken to mean that those United States corporations, as shareholders of ELSI, can lay claim to any rights other than those rights of shareholders guaranteed to them under Italian law as well as under the general principles of law concerning companies. The rights of Raytheon and Machlett as shareholders of ELSI remained the same and were not augmented by the FCN [Friendship, Commerce and Navigation] Treaty. Those rights which Raytheon and Machlett could have enjoyed under the FCN Treaty were not breached by the requisition order, because that order did not affect the 'direct rights' of those United States corporations, as shareholders of an Italian company, but was directed at the Italian company of which they remained shareholders."[217]

To this Judge Schwebel responded:

> "the Judgment largely construes the Treaty of Friendship, Commerce and Navigation between the United States and Italy in ways which sustain rather than constrain it as an instrument for the protection of the rights of the nationals, corporations and associations of the United States in Italy and the rights of nationals, corporations and associations of Italy in the United States. Arguments were pressed on the Chamber which, if accepted, would have deprived the Treaty of much of its value. In particular, it was maintained that the Treaty was essentially irrelevant to the claims of the United States in this case, since the measures taken by Italy (notably, the requisition of ELSI's plant and equipment) directly affected not nationals or corporations of the United States but an Italian corporation, ELSI, whose shares happened to be owned by United States corporations whose rights as shareholders were largely outside the scope of the protection afforded by the Treaty. The Chamber did not accept this argument."[218]

Writers on the Court's decision are in general agreement with Judge Schwebel that the Chamber rejected Judge Oda's position.[219]

82. It is difficult to know exactly what inference is to be drawn from the judgment in *ELSI*. Nevertheless there is substance in the view expressed by Yoram Dinstein that "ELSI removes a certain question mark from *Barcelona Traction* and strengthens the outlook of the majority of the judges who expressed their opinions in the earlier case"[220] in favour of the proposed exception.

83. In their interpretation of the Algiers Declaration of 1981, providing for the settlement of United States-Iran claims,[221] and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States[222] tribunals have

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[217] *1989 I.C.J. Reports*, pp. 87-88.

[218] Ibid., p. 94.

[219] See the authors cited above, footnote 72.

[220] "Diplomatic Protection of Companies under International Law", in *International Law: Theory and Practice* (1988) (ed. K. Wellens), p. 505, at p. 512. Cf. Brigitte Stern, supra note 73, at 925-926, who expresses regret that the Chamber failed to give a clear answer on this question.

[221] 20 *I.L.M.* 230.

[222] United Nations, *Treaty Series*, vol. 575, p. 159; (1965) 4 *I.L.M.* 524.

been prepared to extend the protection of shareholders in a company to claims against the State of incorporation of the company.[223]

*Present status of the exception*

84. Before *Barcelona Traction* there was support for the proposed exception, although opinions were divided over whether, or to what extent, State practice and arbitral decisions recognized it. The obiter dictum in *Barcelona Traction* and the separate opinions of Judges Fitzmaurice, Jessup and Tanaka have undoubtedly added to the weight of authority in favour of the exception. Subsequent developments, albeit in the context of treaty interpretation, have confirmed this trend. Moreover, both the United States[224] and the United Kingdom[225] have declared their support for the exception.

85. Writers remain divided on the issue. Some writers, like Judge Morelli,[226] stress that it is "illogical" and "anomalous" [227] to hold a State responsible for an injury to its own nation. Ian Brownlie argues that:

> "It is arbitrary to allow the shareholders to emerge from the carapace of the corporation in this situation but not in others. If one accepts the general considerations of policy advanced by the Court, then this alleged exception to the rule is disqualified."[228]

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[223] See Sedco Inc v. National Iranian Oil Company and the Islamic Republic of Iran, 84 *I.L.R.* 484, 496 (interpreting article VII(2) of the Algiers Declaration); Liberian Eastern Timber Corporation (LETCO) v. The Government of the Republic of Liberia (1987) 26 *I.L.M.* 647, 652-654 (interpreting article 25 of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States).

[224] In the Sixth Committee debate of 2002 on the report of the Commission, the representative of the United States stated that "a State may exercise diplomatic protection on behalf of its shareholders for unrecovered losses to their ownership interests in a corporation registered or incorporated in another State that is expropriated or liquidated by the State of registration or incorporation, or for other unrecovered direct losses" (A/C.6/57/SR.23, para. 52).

[225] According to its 1985 Rules Applying to International Claims, "where a United Kingdom national has an interest, as a shareholder or otherwise, in a company incorporated in another State and of which it is therefore a national, and that States injures the company, Her Majesty's Government may intervene to protect the interests of the United Kingdom national" (Rule VI), reprinted in (1988) *I.C.L.Q.* 1007.

[226] According to Judge Morelli, the proposed exception would "make havoc with the system of international rules regarding the treatment of foreigners. It would, furthermore, be a wholly illogical and arbitrary deduction", *1970 I.C.J. Reports*, pp. 240-241.

[227] Ian Brownlie, *Principles of Public International Law*, 5th ed. (1998), p. 495. See also E. Jiménez de Aréchaga, "General Course in Public International Law", (1978-1) 159 *Recueil des Cours* ... 7, 290; M. Diez de Velasco, "La protection diplomatique des sociétés et des actionnaires", (1974-1) 141 *Recueil des Cours* ... 87, 166; G. Abi-Saab, "The International Law of Multinational Corporations: A Critique of American Legal Doctrines", (1971) *Annales d'Etudes Internationales* 97, 116.

[228] Supra note 227, at p. 495.

Other writers, like Judge Jessup,[229] support the exception on grounds of equity, reason and justice.[230] Oppenheim declines to take a firm position on the subject, but adds that "a majority of the ICJ" supported such an exception.[231]

86. As indicated above,[232] it is sometimes suggested that the exception is only to be recognized either where the injured company was compelled to incorporate in the wrongdoing State or where the company is "practically defunct". Neither of these qualifications is necessary. Writers in support of the exception on occasion refer to the fact that the reasons for the exception become even stronger when the company has been forced to incorporate in the wrongdoing State, but none limit it to such a case.[233] Nor did the Court in its discussion of this matter in *Barcelona Traction*.[234] As to the other suggested qualification, it is true that the exception has sometimes been invoked in circumstances in which the company was "practically defunct".[235] On the other hand, most commentators maintain that it would be wrong to limit the exception in this way because it shows no understanding of the reason for the exception. As Mervyn Jones states:

> "It seems as if, in the earlier arbitral decisions, excessive or mistaken emphasis was laid on the corporation being in a state of dissolution (e.g. *Delagoa Bay* case) rather than on the factor, always also present, that the injury was done by the State of which the corporation was a national, coupled with the additional factor of the absence of any local effective remedy. The fact that a corporation is 'defunct', as it was put in the *Delagoa Bay* case, is really only relevant in so far as it precludes the possibility of *effective remedy* by corporate action. This consideration really lies at the basis of the exception allowing intervention where the corporation is a national of the State oppressing it."[236]

*Recommendation*

87. The Special Rapporteur supports the exception contained in article 18 (b) without qualification. It enjoys a wide measure of support in State practice, judicial pronouncements and doctrine. Moreover, it seems warranted on grounds of equity, reason and justice. At the very least it should be accepted where the company has been compelled to incorporate in the wrongdoing State, in which case incorporation makes it what some writers have described as a "Calvo corporation",[237] a

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[229] *1970 I.C.J. Reports*, pp. 191-192.

[230] Seidl-Hohenveldern supra note 212; Caflisch supra note 210, G. Sacerdoti, "Barcelona Traction Revisited: Foreign-Owned and Controlled Companies in International Law", in *International Law at a Time of Perplexity: Essays in Honour of Shabtai Rosenne*, ed. Y. Dinstein (1989), p. 699 at p. 703.

[231] *Oppenheim's International Law*, 9th ed., eds. R. Jennings and A. Watts (1992), vol. 1, p. 520, footnote 14.

[232] Supra, para. 66.

[233] See, for example, Seidl-Hohenveldern supra note 212.

[234] *1970 I.C.J. Reports*, p. 48, para 92. See also the separate opinions of Judge Fitzmaurice, ibid., p. 73, and Judge Jessup, ibid., p. 192.

[235] See the *Delagoa Bay Railway Co.* case, supra note 140; D. P. O'Connell, *International Law*, 2nd ed. (1970), vol. 2, p. 1045.

[236] Supra note 159, at 257. See also Beckett, supra note 158, at 190-191; Caflisch, supra note 160, pp. 203-204; Wellington Koo, Separate Opinion, *Barcelona Traction* (Preliminary Objections), *1964 I.C.J. Reports*, p. 58 (para. 21).

[237] P. Reuter, *Droit international public*, 4th ed. (1973), p. 198; Seidl-Hohenveldern, *Corporations in and under International Law* (1987), p. 10; Diez de Velasco, supra note 227, at 166.

corporation whose incorporation, like the Calvo Clause, is designed to protect it from the rules of international law relating to diplomatic protection. Here it is necessary to repeat the warning given by the British Government in *Mexican Eagle*:

> "If the doctrine were admitted that a Government can first make the operation of foreign interests in its territories depend upon their incorporation under local law, and then plead such incorporation as the justification for rejecting foreign diplomatic intervention, it is clear that the means would never be wanting whereby foreign Governments could be prevented from exercising their undoubted right under international law to protect the commercial interests of their nationals abroad."[238]

### 3. Article 19

**Articles 17 and 18 are without prejudice to the right of the State of nationality of shareholders in a corporation to protect such shareholders where they have been directly injured by the internationally wrongful act of another State.**

88. Article 19 is a savings clause designed to protect shareholders whose own rights, as opposed to those of the company, have been injured. That such shareholders qualify for diplomatic protection in their own right was recognized by the Court in *Barcelona Traction* when it stated:

> " ... an act directed against and infringing only the company's rights does not involve responsibility towards the shareholders, even if their interests are affected.
>
> "... The situation is different if the act complained of is aimed at the direct rights of the shareholder as such. It is well known that there are rights which municipal law confers upon the latter distinct from those of the company, including the right to any declared dividend, the right to attend and vote at general meetings, the right to share in the residual assets of the company on liquidation. Whenever one of his direct rights is infringed, the shareholder has an independent right of action. On this there is no disagreement between the Parties. But a distinction must be drawn between a direct infringement of the shareholder's rights, and difficulties or financial losses to which he may be exposed as the result of the situation of the company."[239]

The Court was not, however, called upon to consider this matter any further because Belgium made it clear that it did not base its claim on an infringement of the direct rights of the shareholders.

89. The issue of the protection of the direct rights of shareholders was, so it has been argued,[240] before the Chamber of the International Court of Justice in the *ELSI* case. However, in that case, the rights in question, such as the rights of the shareholders to organize, control and manage the company, were to be found in the Treaty of Friendship, Commerce and Navigation that the Chamber was called on to

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[238] Supra, note 185.

[239] *1970 I.C.J. Reports*, p. 36, paras. 46, 47.

[240] V. Lowe, "Shareholders' Rights to Control and Manage: from *Barcelona Traction* to *ELSI*", in *Liber Amicorum Judge Shigeru Oda*, eds. N. Ando et al. (2002) p. 269; A. Watts, "Nationality of Claim: Some Relevant Concepts", in *Fifty Years of the International Court of Justice. Essays in Honour of Sir Robert Jennings* (1996), p. 424 at 435, footnote 56.

interpret and the Chamber failed to expound on the rules of customary international law on this subject. In *Agrotexim*,[241] the European Court of Human Rights, like the Court in *Barcelona Traction*, acknowledged the right of shareholders to protection in respect of the direct violation of their rights, but held that *in casu* no such violation had occurred.[242]

90. The proposed article leaves two questions unanswered: first, the content of the rights, or when such a direct injury occurs; secondly, the legal order required to make this determination.

91. The Court in *Barcelona Traction* mentions the most obvious rights of shareholders: the right to a declared dividend, the right to attend and vote at general meetings and the right to share in the residual assets of the company on liquidation. This list is not, however, exhaustive, as the Court itself indicated. This means that it is left to courts to determine, on the facts of individual cases, the limits of such rights. Care will, however, have to be taken to draw clear lines between shareholders' rights and corporate rights, particularly in respect of the right to participate in the management of corporations. As Vaughan Lowe has warned, it is necessary to avoid:

> "... the conflation of shareholders' rights with corporate rights, and the elision of the freedom of shareholders to exercise managerial rights under the law of the State of incorporation with the supposed right of shareholders to managerial freedom as a matter of international law."[243]

92. In the discussion on article 18 (a), dealing with the dissolution of a corporation, the question was raised[244] as to the legal system best qualified to make this determination: that of the incorporating State, the wrongdoing State or international law. Similar questions arise in respect of the law to determine whether the direct rights of a shareholder have been violated. The law of the wrongdoing State is no more the appropriate regime to make such a determination than it is to determine whether a company has ceased to exist. In most cases it seems that this is a matter to be decided by the law of the State of incorporation, as with the dissolution of a corporation.[245] That the Court had municipal law, and not international law, in mind as the governing legal order is clear from its own dictum. This may, however, be a case for the invocation of general principles of law,[246]

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[241] Supra note 151.

[242] There the Court stated:
"The Court notes at the outset that the applicant companies did not complain of a violation of the rights vested in them as shareholders of Fix Brewery, such as for example the right to attend the general meeting and to vote. Their complaint was based exclusively on the proposition that the alleged violation of the Brewery's right to the peaceful enjoyment of its possessions had adversely affected their own financial interests because of the resulting fall in the value of their shares. They considered that the financial losses sustained by the company and the latter's rights were to be regarded as their own, and that they were therefore victims, albeit indirectly, of the alleged violation. In sum, they sought to have the company's corporate veil pierced in their favour." Ibid., p. 23, para 62.

[243] Supra note 240, at p.283.

[244] Supra para. 63.

[245] Lowe, supra note 240, at pp. 278-279, states that the law of the State of incorporation is to determine the legal rights of the investor to control the company.

[246] In his separate opinion in *ELSI*, Judge Oda spoke of "the general principles of law concerning *companies" in the context of shareholders' rights: 1989 I.C.J. Reports*, pp. 87-88.

particularly where the company is incorporated in the wrongdoing State, to ensure that the rights of foreign shareholders are not subjected to discriminatory treatment.

**4. Article 20 (Continuous nationality of corporations)**

**A State is entitled to exercise diplomatic protection in respect of a corporation which was incorporated under its laws both at the time of injury and at the date of the official presentation of the claim [; provided that, where the corporation ceases to exist as a result of the injury, the State of incorporation of the defunct company may continue to present a claim in respect of the corporation].**

93. State practice, jurisprudence and doctrine on the subject of the requirement of continuous nationality for the presentation of a diplomatic claim are mainly concerned with the requirement in so far as it relates to natural persons.[247] It will be recalled that the Commission adopted the following draft article on this subject at its fifty-fourth session in 2002:

**"Article 4 [9]**
**"Continuous nationality**

"1. A State is entitled to exercise diplomatic protection in respect of a person who was its national at the time of the injury and is a national at the date of the official presentation of the claim.

"2. Notwithstanding paragraph 1, a State may exercise diplomatic protection in respect of a person who is its national at the date of the official presentation of the claim but was not a national at the time of the injury, provided that the person has lost his or her former nationality and has acquired, for a reason unrelated to the bringing of the claim, the nationality of that State in a manner not inconsistent with international law.

"3. Diplomatic protection shall not be exercised by the present State of nationality in respect of a person against a former State of nationality of that person for an injury incurred when that person was a national of the former State of nationality and not of the present State of nationality."[248]

94. The reason for this special concern with the requirement of continuous nationality in respect of natural persons is understandable. Natural persons change nationality more frequently and more easily than corporations, as a result of naturalization, voluntary or involuntary (as, possibly, in the case of marriage or adoption), and State succession. In addition, too rigid an insistence on a rule of continuous nationality from the time of injury to the time of the presentation of the claim may cause great hardships in individual cases where the change of nationality is unrelated to the bringing of a diplomatic claim. This consideration prompted the exception to the rule contained in paragraph 2 in the above draft article.

95. Similar considerations do not apply in the case of corporations, if the proposal contained in article 17(2) of the present draft articles is accepted. According to this

[247] See further on this subject, the addendum to the present Special Rapporteur's First Report on diplomatic protection, A/CN.4/506/Add.1.

[248] Article 4. See *Official Records of the General Assembly, Fifty-seventh session, Supplement No. 10* (A/57/10), para. 281, p. 178.

provision a corporation takes the nationality of the State in which it is incorporated, and not the State in which it is domiciled or in which it has its *siège social* or by which it is economically controlled. Consequently it may not change its nationality for the purposes of diplomatic protection by relocating its headquarters, domicile or place of control.[249] It may only change its nationality by reincorporation in another State, in which case it assumes a new personality, thereby breaking the continuity of nationality of the corporation. This principle was recognized in the *Orinoco Steamship Company* case.[250] Wherein a company incorporated in the United Kingdom, the *Orinoco Shipping and Trading Company Ltd.*, transferred its claim against the Venezuela Government to a successor company, the *Orinoco Steamship Company*, incorporated in the United States. As the treaty establishing the Commission permitted the United States to bring a claim on behalf of its national in such circumstances, the claim was allowed. However, Umpire Barge made it clear that, but for the treaty, the claim would not have been allowed:

> "[I]t is true that, according to the admitted and practised rule of international law, in perfect accordance with the general principles of justice and perfect equity, claims do not change nationality by the fact that their consecutive owners have a different citizenship, because a State is not a claim agent, but only, as the infliction of a wrong upon its citizens is an injury to the State itself, it may secure redress for the injury done to its citizens, and not for the injury done to the citizens of another State. Still, this rule may be overseen or even purposely set aside by a treaty."[251]

96. The Venezuelan Commissioner, Mr Grisanti, in dissent, was more forceful on this rule when he stated:

> "It is a principle of international law, universally admitted and practised, that for collecting a claim protection can only be tendered by the Government of the nation belonging to the claimant who originally acquired the right to claim, or in other words, that an international claim must be held by the person who has retained his own citizenship since said claim arose up to the date of its final settlement, and that only the Government of such person's country is entitled to demand payment for the same, acting on behalf of the claimant. Furthermore, the original owner of the claims we are analysing was the Orinoco Shipping and Trading Company (Limited), an English company, and that which demands the payment is the Orinoco Steamship Company (Limited), an American company; and as claims do not change nationality for the mere fact of their future owners having a different citizenship, it is as clear as daylight that this Venezuelan-American Mixed Commission has no jurisdiction for entertaining said claims. ... [252]
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> "The fact is that limited companies owe their existence to the law in conformity to which they have been organized, and consequently their

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[249] This is another reason for preferring the State of incorporation as the State of nationality. The adoption of the State of the *siège social*, domicile or economic control as the State of nationality would give rise to serious problems of continuity of nationality, as shown by Eric Wyler, *La Règle Dite de la Continuité de la Nationalité dans le Contientieux International* (1990), pp. 105-108.

[250] 9 *U.N.R.I.A.A.* p. 180 (1903).

[251] Ibid., p. 192.

[252] Ibid., p. 184.

nationality can be no other than that of said law. The conversion of said company, which is English, into the present claimant company, which is North American, can have no retroactive effect in giving this tribunal jurisdiction for entertaining claims which were originally owned by the first-mentioned company, as that would be to overthrow or infringe fundamental principles."[253]

97. Only in one instance may a corporation, possibly, change nationality without changing legal personality, and that is in the case of State succession.[254] However, here too there may be problems relating to the survival of the corporation and the application of the continuity rule. This is illustrated by the *Panevezys-Saldutiskis Railway* case,[255] in which Estonia claimed that it had succeeded to a Tsarist Russian corporation operating in its territory and that this enabled it to bring a claim against Lithuania. Although the Permanent Court of International Justice failed to give a decision on the subject,[256] it highlighted some of the difficulties inherent in such a situation in the following passage:

"The ground on which the Company claims the railway is that it is the same as, or the successor to, the Russian company. The issue as to whether or not it is so involves a decision with regard to the effect of the events and the legislation in Russia at the time of the Bolshevist revolution, for it has been argued that the events and the legislation in Russia put an end to the company's existence and left the devolution of its property outside Russia to be governed by the law of the country in which the property was situated. This question, however, closely affects also the question whether or not there was in existence at the time of the Lithuanian acts giving rise to the present claim an Estonian national whose cause the Estonian Government was entitled to espouse."[257]

98. In all the circumstances it seems appropriate to require that a State which exercises diplomatic protection on behalf of a corporation must prove that the corporation was a national under its laws both at the time of injury and at the date of the official presentation of the claim. This leaves one question unanswered, however: if the corporation ceases to exist in its place of incorporation as a result of an injury caused by the internationally wrongful act of another State, must a claim against the wrongdoing State be brought by the State of nationality of the shareholders, in accordance with proposed article 18(a), or may it be brought by the State of nationality of the defunct corporation? To put the question in the context of *Barcelona Traction*: if the Barcelona Traction company had ceased to exist in Canada as a result the injury caused to the company by Spain, would the claim have passed completely to Belgium, the national State of the shareholders? Or would

253 Ibid., p. 186.

254 See generally on this subject D. P. O'Connell, *State Succession in Municipal Law and International Law*, vol. I, Internal Relations, pp. 537-542. See also Fourth Report on nationality in relation to the succession of States, A/CN.4/489, which highlights the difficulties surrounding the nationality of legal persons in relation to the succession of States.

255 *P.C.I.J. Reports*, *Series A/B* 76, p. 4 (1939).

256 Ibid., p. 17. The Court attached this matter to the merits but then upheld a preliminary objection based on the failure to exhaust local remedies.

257 Ibid., p. 17. See also the dissenting opinion of Judge van Eysinga, ibid., p. 30 at pp. 33, 35; and the separate opinion of Judge Fitzmaurice in *Barcelona Traction, 1970 I.C.J. Reports*, pp. 101-102.

Canada have retained its right to claim on behalf of its defunct corporation? Alone? Or together with Belgium?

99. The difficulties inherent in such a situation for both company and shareholders were alluded to in *Barcelona Traction* by Judges Jessup and Gros and Judge ad hoc Riphagen. Judge Jessup highlighted the anomaly of the case in which a foreign corporation is destroyed by the confiscatory act of a State, followed by a consequent dissolution in its own State. "Here", he said, "some doctrine would say that ordinarily State A, the State of incorporation, should be the one to extend diplomatic protection. But by hypothesis the corporate life has been extinguished by State A, so that ... a claim can not be pressed for the corporation."[258] Consequently the State of incorporation could not meet the requirements of the continuity rule that the corporation be a national both at the time of the injury and at the time of the presentation of the claim. Nor, however, could the shareholders meet these requirements, as "at the time of the unlawful act ('confiscation') they did not have ... a property interest and therefore under the rule of continuity the claim did not have in origin the appropriate nationality on that basis."[259]

100. Judge Gros argued that the only way out of this dilemma was to allow both the State of incorporation and the State of nationality of the shareholders to exercise diplomatic protection:

> "... the Judgment's view which admits the possibility of action by the State of the shareholders in the event of the disappearance of the company is lacking in logic for, in such an eventuality, if the company's State had started an action it could not be non-suited through the disappearance of the company. And even if such action had been instituted after the disappearance of the company, it is difficult to see why the State of the company should be unable to make a claim in respect of the unlawful act which was the root cause of the disappearance. If then, in this case, both States can act, does this not mean that the general rule conferring the right of action on the State of the company is not an exclusive rule?" [260]

101. Judge ad hoc Riphagen found the Court's decision that the right of the shareholders to claim only came into existence on the demise of the company to be unrealistic and unsatisfactory. He stated:

> "On the level of municipal private law, it is not the company's going into liquidation which causes a right to arise for each shareholder, namely a right to a part of the company's property: It is only at the *end* of the liquidation that any *surplus* there may be is distributed among the shareholders. Furthermore, the liquidation was always *subsequent* to the measures taken by the State which was held responsible on the international plane, so that those measures could not have infringed the rights of the shareholders on the municipal private law plane.
>
> "....
>
> "The Judgment observes (paragraph 66) that 'only in the event of the legal demise of the company are the shareholders deprived of the possibility of a

[258] *1970 I.C.J. Reports*, p. 193.

[259] Ibid.

[260] Ibid., p. 277.

remedy available through the company.' The Judgment does not explain how in such a case, after the legal demise of the company, the action of a Government *other* than the company's Government might be compatible with the rule of continuity! In reality, the legally protected interest of such other State, and consequently also the obligations towards it of the State which took the measures of which complaint is made, must exist on the international plane before and independently of the company's demise on the plane of municipal law, a demise which is but one of the *possible* consequences of these measures."[261]

102. Difficulties of the kind raised above have also troubled courts[262] and scholars.[263]

103. It is suggested that the solution to this problem does not lie in a technical, logical rule[264] that seeks to determine the precise moment of corporate death at which the right of the State of nationality to exercise diplomatic protection in respect of a company gives way to the State of nationality of the shareholders. Instead an equitable rule should be sought which takes account of the customary long lapse of time between the date of injury and the date of presentation of the claim and of the difficulty in determining the precise moment at which the company's rights are replaced by those of the shareholders. Moreover, such a rule should be without prejudice to the interests of either company or shareholders. The proviso to article 20 contains such a rule as it would allow the State of nationality of the company to continue to protect the company after its demise occasioned by the injury to the company. The consequence of this proviso would not, however, be to exclude the right of the State of nationality of the shareholders to initiate a claim when the company ceased to exist, despite the fact that a strict application of the continuity rule might bar such a State from protecting shareholders if (as will be usually be the case) the injury occurred before the dissolution of the company.

104. A necessary consequence of this proposal is that there will be a grey area in time in which both the State of nationality of the company and the State of nationality of the shareholders might bring diplomatic claims. In theory no fault can be found with such a duality of claims. The diplomatic protection of dual nationals by two States and of international civil servants by both organization and State shows that such a solution is not out of line with existing rules.[265] Nor is it likely to raise problems in practice. Both protecting States are likely to behave with caution in taking up the claims of their nationals in the grey area in time. Moreover, as Judge Jessup observed in *Barcelona Traction:*

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[261] Ibid., p. 345.

[262] See the *Kunhardt* claim (*United States* v. *Venezuela*), 9 *U.N.R.I.A.A.* p. 171 (1903), and particularly the dissenting opinion of the Venezuelan Commission, Mr. Paúl, at p. 180; *F. W. Flack, on behalf of the Estate of the Late D. L. Flack (Great Britain)* v. *United Mexican States*, 5 *U.N.R.I.A.A.* p. 61 (1929) at p. 63. Wyler argues that the *ELSI* case (*1989 I.C.J. Reports* 15) might also have raised problems of this kind; supra note 249, at pp. 200-201.

[263] Beckett, supra note 158, at 191; Caflisch, supra note 160, at pp. 206-207; Wyler, supra note 249, at pp. 197-202.

[264] See the separate opinions in *Barcelona Traction* of Judges Fitzmaurice (*1970 I.C.J. Reports*, pp. 101-102) and Jessup (ibid., pp. 202-203) in support of such an approach.

[265] See above, para. 34. See also L. C. Caflisch, "The Protection of Corporate Investments Abroad in the Light of the Barcelona Traction Case", (1971) 31 *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* 162, 193.

> "In case of two different but simultaneous justifiable diplomatic interpositions regarding the same wrongful act, the Respondent can eliminate one claimant by showing that a full settlement has been reached with the other."[266]

105. Article 20 (including the proviso) is concerned with the continuity rule in respect of *corporations*. Article 4 of the present draft articles deals with the continuity rule in respect of natural persons. The latter rule will cover shareholders when they are natural as opposed to corporate persons. It therefore seems unnecessary to draft a separate continuity rule for shareholders. Where a State of nationality of shareholders seeks to intervene on behalf of its nationals in the circumstances set out in articles 18 (b) and 19 and, in most instances, those of article 18(a) (subject to the grey zone scenario described in paragraph 85), it will have to comply with the requirements of the continuity rule prescribed in article 4.

[266] *1970 I.C.J. Reports*, p. 200.